MINERAL TREATMENT PROCESSES FOR PERCENTAGE DEPLETION PURPOSES

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HEARINGS

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

EIGHTY-SIXTH CONGRESS

FIRST SESSION

ON

THE LEGISLATIVE PROPOSAL OF THE TREASURY DEPARTMENT SPECIFYING THE TREATMENT PROCESSES WHICH SHALL BE CONSIDERED MINING FOR THE PURPOSE OF COMPUTING PERCENTAGE DEPLETION IN THE CASE OF MINERAL PRODUCTS

MARCH 5, 6, 9, 10, AND 11, 1959

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MINERAL TREATMENT PROCESSES FOR PERCENTAGE DEPLETION PURPOSES

THURSDAY, MARCH 5, 1959

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met at 10 a.m., pursuant to recess, in the committee room, New House Office Building, Hon. Wilbur D. Mills (chairman) presiding.

The CHAIRMAN. The committee will please come to order.

Our first witness this morning is David A. Lindsay, assistant to the Secretary of the Treasury Department.

Mr. Lindsay, you are accompanied by the other gentlemen there. For purposes of the record, will you identify them, please, sir?

STATEMENT OF DAVID A. LINDSAY, ASSISTANT TO THE SECRETARY, TREASURY DEPARTMENT, ACCOMPANIED BY JAY W. GLASMANN, ASSISTANT GENERAL COUNSEL; EDWARD C. RUSTIGAN, ASSISTANT HEAD, LEGAL ADVISORY STAFF, TREASURY DEPARTMENT; PAUL F. SCHMID, ASSISTANT HEAD, LEGISLATION AND REGULATIONS DIVISION; AND RUSSELL C. McGINNIS, ASSISTANT CHIEF, NATURAL RESOURCES SECTION, INTERNAL REVENUE SERVICE

Mr. LINDSAY. I have with me on my left Mr. Jay Glasmann, Assistant General Counsel of the Treasury, and on his left, Mr. Paul Schmid, assistant head of the Legislation and Regulations Division of Chief Counsel's Office; on my right, Mr. Edward C. Rustigan, assistant head of the legal advisory staff, and on his right, Mr. Russell McGinnis, Assistant Chief of the Natural Resources Section of the Internal Revenue Service.

The CHAIRMAN. You are recognized, Mr. Lindsay.

Mr. LINDSAY. I would like to divide the reading of the prepared statement with Mr. Jay Glasmann.

The CHAIRMAN. Before you begin I would like to insert at this point a press release pertaining to this hearing and correspondence from the Honorable Robert B. Anderson, Secretary of the Treasury, addressed to the Honorable Sam Rayburn, of Texas, Speaker of the House of Representatives, complete with a proposed bill. Then you may proceed as you desire.

[Press release for immediate release, Thursday, Feb. 12, 1959, Committee on Ways and Means, New House Office Building, Washington, D.C.]

CHAIRMAN WILBUR D. MILLS, DEMOCRAT, OF ARKANSAS, COMMITTEE ON WAYS AND MEANS, HOUSE OF REPRESENTATIVES, RELEASES TREASURY DEPARTMENT'S PROPOSED DRAFT OF LEGISLATION SPECIFYING THE TREATMENT PROCESSES WHICH SHALL BE CONSIDERED MINING FOR THE PURPOSE OF COMPUTING PERCENTAGE DEPLETION IN THE CASE OF MINERAL PRODUCTS

Chairman Wilbur D. Mills, Democrat, of Arkansas, Committee on Ways and Means, House of Representatives, today released the attached letters from the Secretary of the Treasury to the Speaker of the House of Representatives, dated January 26, 1959, and February 11, 1959, respectively, and the proposed draft of legislation submitted by the Treasury Department specifying the treatment processes which shall be considered mining for the purpose of computing percentage depletion in the case of mineral products.

It will be recalled that Chairman Mills announced on February 9, 1959, that hearings have been scheduled by the Committee on Ways and Means to receive testimony on this subject, and that the chairman stated in that press release that the Treasury's draft of proposed legislation would be made available when received.

Chairman Mills emphasized that the testimony during the hearings would be limited to the area covered by the specific recommendations of the Secretary of the Treasury.

THE SECRETARY OF THE TREASURY,
Washington, D.C., January 26, 1959.

HON. SAM RAYBURN,
Speaker of the House of Representatives,
Washington, D.C.

MY DEAR MR. SPEAKER: In the budget message of the President, submitted to Congress on January 19, 1959, the President stated that the Treasury Department would recommend an amendment to the Internal Revenue Code specifying the treatment processes which shall be considered mining for the purpose of computing percentage depletion in the case of mineral products.

Early last year I testified before the Ways and Means Committee on the need to revise the law in order to preclude excessive depletion deductions for the brick and cement industries. My recommendation was made as a result of a series of court cases which permitted manufacturers of brick and cement to compute percentage depletion on the basis of the selling price of the finished manufactured product rather than on the value of the clay or cement rock before it is manufactured.

It is now apparent under the court decisions that manufacturers of many other products may obtain depletion allowances based on gross income derived from the sale of finished products. This can only result in increasing the depletion deduction for all minerals severalfold—in extreme cases as much as 100 times. I do not believe that depletion on such an inflated scale is either reasonable or was intended. If permitted, the revenue losses will indeed be serious.

The problem arises because the term "mining" is defined in the statute to include the ordinary treatment processes normally applied to obtain the "commercially marketable mineral product or products" which, in many instances, may be an expensive finished product. Accordingly, in order to prevent excessive depletion allowances, I recommend the immediate elimination of the phrase "commercially marketable mineral product or products" from the statute and the substitution of a new definition of "mining" which will specify the allowable treatment processes for the various minerals.

The proposed legislation would not only prevent a substantial loss in revenue, but would also help resolve difficult and complex problems in determining for many mineral industries the stage at which taxpayers first obtain a commercially marketable mineral product.

The staff of the Treasury is now preparing a draft of the proposed legislation, and in this connection would be pleased to work in cooperation with the Ways and Means Committee staff and the joint committee staff in its development.

Sincerely yours,

ROBERT B. ANDERSON,
Secretary of the Treasury.

THE SECRETARY OF THE TREASURY,
Washington, D.C., February 11, 1959.

Hon. SAM RAYBURN,
Speaker of the House of Representatives,
Washington, D.C.

MY DEAR MR. SPEAKER: On January 26, 1959, I wrote you concerning the need for an amendment to the Internal Revenue Code specifying the treatment processes which shall be considered mining for the purpose of computing percentage depletion in the case of minerals. The enclosed draft of proposed legislation would implement the recommendations which I made in that letter for minerals.

During the consideration of this legislation by the Congress we shall continue to work cooperatively with the congressional tax staffs in the development of the legislation, with particular reference to making certain that appropriate treatment is given all affected industries.

It would be appreciated if you would lay the proposed legislation before the House of Representatives. A similar proposal has been submitted to the President of the Senate.

Sincerely yours,

ROBERT B. ANDERSON,
Secretary of the Treasury.

A BILL To specify processes which shall be considered mining for the purpose of computing percentage depletion in the case of minerals and ores, and to revise the depletion rates with respect to certain clays when used to make common brick and title products

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. DEPLETION RATE FOR CERTAIN CLAYS AND TREATMENT PROCESSES CONSIDERED AS MINING FOR COMPUTING PERCENTAGE DEPLETION IN THE CASE OF MINERALS AND ORES.—(a) Depletion Rate for Certain Clays.—Subsection (b) of section 613 (relating to percentage depletion rates) is amended as follows:

(1) Paragraph (3) is amended to read as follows:

"(3) 15 percent—

"(A) metal mines (if paragraph (2)(B) does not apply), rock asphalt, and vermiculite; and

"(B) if paragraph (5)(B) does not apply, ball clay, bentonite, china clay, sagger clay, and clay used or sold for use for purposes dependent on its refractory properties."

(2) Paragraph (5) is amended to read as follows:

"(5) 5 percent—

"(A) gravel, mollusk shells (including clam shells and oyster shells), peat, pumice, sand, scoria, shale, and stone, except stone described in paragraph (6);

"(B) clay used, or sold for use, in the manufacture of building or paving brick, drainage and roofing tile, sewer pipe, flower pots, and kindred products; and

"(C) if from brine wells—bromine, calcium chloride, and magnesium chloride."

(3) Paragraph (6) is amended by striking "refractory and fire clay,".

(b) Treatment Processes Considered as Mining.—Subsection (c) of section 613 (relating to the definition of gross income from property) is amended as follows:

(1) Paragraph (2) is amended to read as follows:

"(2) MINING.—The term 'mining' means the extraction of the ores or minerals from the ground, the treatment processes considered as mining described in paragraphs (3) and (4), and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which such treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary or his delegate finds that the physical and other requirements are such that the ore or mineral must be transported to a greater distance to such plant or mills."

(2) Paragraph (3) is redesignated paragraph (5).

(3) Paragraph (4) is deleted and the following paragraphs are inserted in lieu thereof:

"(3) TREATMENT PROCESSES CONSIDERED AS MINING.—The following treatment processes where applied by the mine owner or operator with respect to the minerals or ores extracted from the ground by him shall be considered as 'mining'—

"(A) In the case of coal—cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment:

"(B) In the case of sulfur recovered by the Frasch process—pumping to vats, cooling, breaking, and loading for shipment;

"(C) In the case of all other minerals or ores—(i) where applied to crude minerals or ores—crushing, grinding, sorting, screening, washing, and drying to remove free moisture; (ii) beneficiation by concentration, and the processes necessary thereto; (iii) beneficiation by cyanidation, leaching, crystallization, or precipitation, and the processes necessary thereto; (iv) any additional process, if necessary, to bring the mineral or ore to form and condition suitable for shipment; and (v) loading for shipment. For purposes of this subparagraph, the term 'beneficiation by concentration' means the application of processes solely for the purpose of eliminating waste, or separating the mineral or ore from other minerals or ores, by gravity, flotation, amalgamation, electrostatic means, magnetic means, or substantially equivalent processes. The processes referred to in (IV) are those processes which are necessary to bring the mineral or ore to the physical form and condition in which it is capable of being transported as distinguished from those processes applied to make the mineral or ore saleable. The term 'loading for shipment' shall not include the cost of packaging unless otherwise provided for under (iv), nor shall it include the cost of containers, bags, or any similar items;

"(D) The pulverization of talc, the burning of magnesite, the furnacing of quicksilver ores, and the sintering and nodulizing of phosphate rock.

"(4) TREATMENT PROCESSES NOT CONSIDERED AS MINING.—The following treatment processes shall not be considered as 'mining'—

"(A) In the case of all minerals or ores—electrolytic deposition, roasting, calcining, thermal or electric smelting, refining, polishing, fine pulverization, blending with other materials, treatment effecting a chemical change, thermal action, and molding or shaping, unless such processes are otherwise provided for in paragraph (3); and

"(B) Notwithstanding any other provisions of this subsection, any treatment process which follows a process that is not considered as 'mining' will not be considered as mining for the purpose of this subsection."

SEC. 2. EFFECTIVE DATE.—The amendment made by this Act shall be applicable only with respect to taxable years beginning after December 31, 1958.

Mr. LINDSAY. Mr. Chairman and members of the Ways and Means Committee, I want to thank you for this opportunity to present the administration's legislative recommendations concerning the computation of gross income from mining.

In the budget message of the President, submitted to the Congress on January 19, 1959, the President stated that the Treasury Department would recommend an amendment to the Internal Revenue Code specifying the treatment processes which shall be considered mining for the purpose of computing percentage depletion in the case of mineral products.

The Secretary of the Treasury has since submitted to the Congress two drafts of proposed legislation which we believe will resolve the difficult problems involved in determining the point at which to measure the amount of income which is derived from mining, or mineral extraction. The problem which has arisen in this area is an extremely important one, which could, in time, involve literally hundreds of millions of dollars in revenue.

In our view, this legislative recommendation is one of the most important pieces of tax legislation which will be considered by the Congress this year.

Let me illustrate with a simple example the nature of the problem which we have before us.

A producer of steel products who mines the iron ore used in his business is entitled to a percentage depletion deduction equal to 15 percent of his gross income derived from his mining operations. Two tons of iron ore, which this producer extracts from the ground, can be processed into about 1 ton of pig iron, and the 1 ton of

pig iron can then be processed into about 1 ton of steel products. The selling price of 2 tons of iron ore is about $16. The selling price of 1 ton of pig iron is about $60. The selling price of 1 ton of steel products will vary widely depending upon the product involved. It ranges generally from about $110 for a ton of simple structural steel to $295 for a ton of structural steel bolts.

The Treasury Department takes the position that a producer of steel products is entitled to compute his depletion deduction on the value of the iron ore. In this example, the depletion deduction would be $2.40. If producers were permitted to compute their depletion deduction on the value of the pig iron, the deduction in this example would be $9, which is about four times the deduction based on the value of the iron ore.

At least one producer takes the position that it is entitled to compute its depletion deduction on the selling price of its finished steel products.

If this extreme position were to prevail, the deduction in the case of the structural steel would be $16.50, which is almost seven times the deduction based on the value of the iron ore, and $44.25 in the case of the structural steel bolts, which is over 18 times the deduction based on the value of the iron ore.

As you know, the Department has submitted two drafts of proposed legislation, one dealing with all minerals except oil and gas, and one dealing only with oil and gas. Together these draft bills would specify for all minerals the processes which shall be treated as mining for the purpose of measuring the amount of gross income derived from mineral extraction. While both drafts are designed to accomplish the same purpose, there are technical problems which make it necessary to prescribe separate statutory rules for oil and gas on the one hand and for all other minerals on the other.

I should like first to discuss the area of minerals other than oil and gas.

The Internal Revenue Code provides that in the case of minerals other than oil and gas, gross income for depletion purposes means "gross income from mining." Mining is in turn defined to mean not merely the extraction of the minerals or ores from the ground, but also "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products."

In addition, the statute specifies certain processes which shall be considered "ordinary treatment processes" and certain other processes which shall not be considered ordinary treatment processes. In general, this means treating as mining the extraction of the ore or mineral from the ground, the separation of the ore or mineral from waste material or from other ores or minerals, and the loading of the ore or mineral for shipment. As stated by the Supreme Court in *Helvering* v. *Bankline Oil Company* (1938, 303 U.S. 362), the purpose underlying the deduction for depletion is to compensate the taxpayer for the exhaustion of a mineral reserve.

Consistent with this purpose, the Treasury Department has long interpreted the statute to mean that the gross income to be used in the computation of the depletion deduction is the gross income attributable to treatment processes equivalent to those specifically named in the statute. Accordingly, the Department has maintained that any other or further processing of the mineral to market a finished product should be disallowed as manufacturing or nonmining.

In recent years taxpayers have successfully contended in a series of court cases for a broader interpretation of the term "ordinary treatment processes." In many cases the courts have held that this term embraces virtually all processes which a taxpayer applies to produce the particular product or products which he markets.

The courts have held that the processes specifically designated in the statute are illustrative only and do not limit the applicability of the term "ordinary treatment processes" to those specifically named.

The effect of those decisions is that depletion may be taken on the costs and profits attributable to the production and sale of expensive manufactured products. A few examples from litigated cases will illustrate this point.

In the case of brick and tile clay, depletion has been based upon the income from the sale of finished building brick; in the case of limestone, on the income from the sale of bagged cement and lime; in the case of talc, on the income from the sale of finished and packaged crayons; in the case of slate, on the income from the sale of roofing shingles; and in the case of refractory clay, upon the income from the sale of highly expensive finished refractory and ceramic products.

A case is now pending before the Court of Claims in which a taxpayer mining salt contends that all processes applied to arrive at a refined table salt packaged in various sized containers are ordinary treatment processes. If the taxpayer prevails in this claim, his depletion deduction in the case of small containers of salt will be well over 100 times the deduction allowable on crude salt. If the present trend continues, it is entirely possible that taxpayers mining iron ore and bauxite will claim that all the processes applied to arrive at pig iron and pig aluminum are ordinary treatment processes.

In fact, it is conceivable that fully integrated operators might successfully claim depletion on products involving even further processing into other manufactured products.

Major problems under existing law:

The trend of the decided cases has created four major problem areas under the existing statute which I would like to outline briefly before discussing the draft bill. These are:

First. Substantial loss of revenues;

Second. Increased difficulty in administering the statute;

Third. Inequitable treatment as between taxpayers in different industries; and

Fourth. Acceleration of the trend toward fully integrated operations.

A survey recently has been conducted by the Treasury to determine, to the extent posible, what the revenue effects might be if the depletion allowance is extended to the sales price of finished manufactured products.

The results of this survey are shown in tables I, II, and III, which appear at the end of this statement.

Table I sets forth, by mineral, the dollar amounts of tax currently in controversy on this issue at the administrative level in the Internal Revenue Service and in litigation in the Federal courts of the United States.

In general, table I covers the taxable years 1951 through 1957. It shows that the Government could sustain a tax loss of nearly $297 million for these years if all taxpayers whose claims are now on file were to recover the amounts claimed.

The figure does not, however, represent the total possible tax loss for the years 1951 through 1957.

For example, the figure of $297 million does not include tax losses already sustained as a result of litigated court cases, nor does it include the losses already incurred administratively as a result of the settlement of cases on the basis of a number of court decisions establishing a cutoff for a particular mineral, such as brick and tile clay.

Furthermore, revenue agents in the field have indicated that many of the claims for refund presently on file represent only "test" cases for the particular taxpayers concerned. If these taxpayers prevail in their claims, additional refund claims for all years not closed by the statute of limitations can be anticipated.

Table II sets forth the annual estimated tax loss which could result if the depletion base for mining is extended to include manufactured products across the board. The Treasury believes that the estimated annual loss of revenue shown is modest. Because of lack of available data, this estimate does not include losses which might result if depletion were based on the gross income from products manufactured from such minerals as coal, petroleum, and gas.

Table II covers 19 categories of minerals and ores. It shows that the Government may for these categories sustain an annual revenue loss of $598 million. This estimate is based upon the assumption, which we hope will not materialize, that producers of the designated minerals and ores will obtain depletion not only on such manufactured products such as brick and cement, but also on such items as finished steel products.

Unfortunately, the language in a number of the recent court decisions suggest that there is a real and present danger that existing law may be interpreted to go so far.

Table III lists individual producers of finished mineral products who have obtained or are currently claiming percentage depletion on manufactured products. It sets forth the amount of tax contested in a number of actual tax cases. I particularly want to call your attention to the substantial percentage increase in the depletion deduction which individual taxpayers will obtain if they succeed in their claims that the depletion allowance is based on income from manufacturing processes.

The language of the present statute creates substantial administrative problems, most of which stem from the definition of ordinary treatment processes in terms of processes normally applied to obtain "the commercially marketable mineral product or products."

As I have already indicated, in some cases the courts have held that the term "commercially marketable mineral product or products" means that a taxpayer is entitled to depletion on virtually all the processes which he applies to produce the particular product or products which he markets. This extreme view may solve most of the administrative problems otherwise involved in applying a depletion cutoff rule, but not all of the court decisions have gone this far.

Several courts have indicated that only those processes required to reach the first commercially marketable product rather than the particular product or products produced by the taxpayer are to be considered mining. However, these decisions leave substantial questions unresolved.

For example, is the first marketable product the first salable product actually manufactured by the taxpayer even though he processes the

product further before selling it, or does it mean the first product which he might have made?

If the latter is such first marketabe product determined on the basis of sales of other manufacturers in the taxpayer's local area, or is the test of first marketability of a product to be made on an industrywide or national basis? The problem is further complicated where the producer is extracting a mineral which is found in many different grades.

Present law sets forth a category for minerals which are customarily sold in the crude form, and describes particular processes which will be considered ordinary treatment processes for those minerals.

Present law also sets forth a category for ores which are not customarily sold in the crude form, and describes certain other processes which will be considered ordinary treatment processes for these ores. Experience has shown that these two distinct categories create difficult administrative problems particularly because there are some products which do not fit in either category.

Examples are brick and tile clay, and cement rock, which do not fall in the ore category because they are not technically ores, and which also do not fall in the mineral category because they are customarily sold in a processed rather than a crude form.

As you all know, there are varying rates of depletion, ranging from 5 to 23 percent in the case of minerals other than oil and gas. These varying rates reflect the considered judgment of Congress that in the light of all the circumstances certain minerals should receive a higher rate of depletion than others.

In certain instances, however, the congressional purpose may well be defeated by the commercially marketable product test.

For example, under the court decisions a mineral assigned a lower depletion rate may obtain a greater depletion allowance than a mineral assigned a higher depletion rate. This is because the lower depletion rate, when applied to the income from an expensive manufactured product, may produce a larger deduction than the higher depletion rate when applied to the income from an inexpensive crude mineral which may qualify as a marketable product.

The existing law provides, in the case of minerals which are customarily sold in the form of the crude mineral products, that a producer may treat as mining those processes necessary to bring a mineral to form and condition suitable for shipment.

Present law creates a discrimination against producers of ores not customarily sold as crude minerals. Such producers of ores may not treat as mining processes those processes necessary to bring a mineral to form and condition suitable for shipment, and loading for shipment.

If the trend of the cases continues, it appears that in cases where substantially all the producers of a particular mineral are integrated producers, they may be allowed to claim depletion on their finished product.

The best example of this treatment is found in the brick and tile clay industry, where substantially all the producers of clay process their clay into bricks and other finished clay products. Under these circumstances, integrated producers will be encouraged to absorb the nonintegrated producers so as to eliminate existing markets for the crude mineral product, particularly in those mineral industries where there are now relatively limited sales of the crude material.

I shall now ask Mr. Glasmann to continue with the prepared statement on the description of the draft bill on mining.

The CHAIRMAN. You are recognized, Mr. Glasmann.

Mr. GLASMANN. The draft bill on mining is intended to restore the rules for computing gross income from mining which were applied prior to the recent court decisions. No attempt has been made to roll back those processes which are treated as mining under express provisions of the statute or by administrative practice.

This bill does not deal with rates of depletion or any other depletion questions, with one limited exception: In order to avoid competitive inequalities, the draft bill provides that all clay producers whose clay is used in the manufacture of ordinary brick and tile products will be entitled to a 5 percent depletion rate.

In broad outline, the draft bill eliminates the commercially marketable product test for determining what processes enter into mining. Instead of the marketability test, which is the source of most of the trouble under the present statute, the draft bill specifies the allowable mining processes and also those which are not allowable as mining.

Now let us examine the bill in closer detail beginning with the definition of mining and nonmining processes.

Certain processes in the case of coal, sulfur recovered by the Frasch process, quicksilver ores, talc, magnesite, and phosphate rock which are treated as mining in the present statute are also treated as mining in the draft bill. Similarly, the draft bill continues to treat as mining certain other processes which present law specifically designates as mining, such as cyanidation, leaching, crystallization, and precipitation.

In addition, the definition of processes considered to be mining is broadened in the draft bill to include those processes which have been treated as mining under established administrative practice.

For example, under administrative practice, sorting, screening, and washing have been treated as mining processes even though they are not expressly named in the statute. The draft bill specifically provides that these processes are considered to be mining.

The draft bill also specifies various treatment processes which shall not be considered mining. The list of disallowed processes includes all those which present law specifically describes as nonmining processes, such as roasting, thermal and electric smelting, and refining. In addition, the list includes such processes as calcining, polishing, and fine pulverization, which the Department has always treated as nonmining processes in its administration of the law.

Although the draft bill specifically provides that certain processes will not be considered mining processes as such, it also provides that any of the disallowed manufacturing processes will be treated as mining, as they have in the past, where such processes are necessary to, or are an integral part of, separating the mineral from waste, termed "beneficiation by concentration" in the draft bill.

Moreover, such manufacturing processes will be treated as mining where they are necessary to, or an integral part of, certain other specifically named beneficiation processes. These processes are cyanidation, crystallization, precipitation, and leaching.

As previously indicated, the present statute differentiates between certain processes which will be considered mining processes when

applied to "minerals which are customarily sold in the form of a crude mineral product," and certain other processes which will be considered mining processes when applied to "ores which are not customarily sold in the form of the crude mineral product."

The draft bill would erase the distinction by setting up a single category of processes recognized as mining for minerals and ores. This will not only simplify administration of the law, but will also liberalize the law by permitting producers of ores to treat as mining processes those processes necessary to bring a mineral or ore to the physical form and condition in which it is suitable for shipment, and loading for shipment. Under the present statute, these processes are treated as mining only in the case of minerals customarily sold in the crude form.

In addition, the revised language provides, consistent with administrative practice, that the processes which will be treated as necessary to make the mineral or ore suitable for shipment are those which are necessary to bring the mineral or ore to the physical form and condition in which it is capable of being transported as distinguished from those processes applied to make the mineral or ore salable.

The draft bill contains a very important cutoff clause which states that any process which follows a process not considered as mining shall also not be considered as mining. The reasoning behind this provision is that after the application of manufacturing processes, the mineral or ore is no longer in crude form, and, therefore, any subsequent process regardless of its nature should not be treated as mining.

For example, in the case of cement manufacturers, this cutoff clause would deny crushing and grinding of the clinker after burning in the kiln, since burning in the kiln is considered a manufacturing process.

Since the release by this committee of the draft bill on mining processes, we have had the opportunity to confer with a number of persons representing individual mineral producers and groups of mineral producers regarding possible problems under the bill. These discussions have been very helpful to us, and I am pleased to say that many of the questions raised do not appear to present any real differences of opinion and can be clarified.

I would like to discuss two of those questions, however, which are of particular significance.

The draft bill states that any treatment process which follows a process that is not considered as mining will not be considered as mining. This is the cutoff clause of the bill which is designed to prevent mineral producers from claiming that certain processes are mining processes after manufacturing has begun.

The fear has been expressed that this provision may deny depletion on subsequent mining processes when the chain of mining processes is broken by a nonmining process which really should be treated as a neutral process.

For example, coal may be sprayed with paint, or confetti printed with the name of the company may be sprinkled in with the coal. These nonmining processes may occur before the coal is screened and loaded for shipment, processes now recognized as mining. Concern has been expressed that the cutoff clause, as now drafted, may exclude such processes from the depletion base merely because they occur after such an insignificant nonmining process.

The Department does not intend to disallow otherwise allowable processes under the cutoff clause merely because of the intervention

of a neutral process of this type, and the bill can be easily clarified in this area without substantially changing the important cutoff provision.

I would like to stress again why this provision is needed. It is needed to prevent processes such as crushing, grinding, and loading for shipment, which are recognized as mining processes when applied to a crude material, from being treated as mining processes when applied after manufacturing has begun. Without such a cutoff provision, a statute specifying allowable treatment processes by name would be of little help in solving the problems which have arisen under present law.

The second important question that has been raised under the draft bill has to do with the brick and tile and cement industries.

The draft bill which was submitted to the Congress last year, relating to brick and tile clay and cement rock, specifically listed filtering of slurry in the wet process as a mining process in the case of cement. The draft bill now before this committee does not specifically refer to filtering of slurry.

Concern has been expressed as to whether there is any intent to give the cement industry less favorable treatment under the present bill than under the bill which this Department transmitted to the Congress last year.

You may recall that the bill which was submitted last year was intended to reflect established practice as set forth in a 1953 revenue ruling and as established by practice in the case of processes not covered by the ruling; that is, to allow crushing and grinding, including the filtering of slurry in the wet process, prior to burning in the kiln. The Department did not intend in drafting this bill to cut back on the processes which have been recognized as mining in the case of the cement industry.

In this connection I would like to discuss a problem which has given us a good deal of concern. There are instances, both in the present statute and under administrative practice, where mineral producers are allowed depletion on processes which would be considered manufacturing under the general rules of our draft bill.

In preparing the draft no attempt was made to cut back those instances of special treatment, although, in the case of cement, the technical language of the bill may have inadvertently reached such a result. If so, and if the committee wishes to codify the existing administrative practice for cement, the Treasury would not object.

However, it may be appropriate to point out that such administrative and statutory exceptions may be difficult to justify, particularly because they may form the basis for pleas by other mineral producers for special treatment. It is our hope, therefore, that if Congress should choose to continue the existing exceptions, it will not regard them as a precedent for further statutory exceptions to the general rule for determining the cutoff point for depletion.

Mr. LINDSAY. I will now turn to the oil and gas legislation.

I should like to discuss briefly our proposed draft of legislation specifying the cutoff points for determining percentage depletion in the case of oil and gas. The Treasury recommendations in this area were released to the public for the first time March 3.

As the affected industries will need time to prepare their comments, we understand that this subject will not be covered in the present

hearings. We do want to stress, however, the importance of this proposed legislation pertaining to the oil and gas industries and request that the matter be given early consideration by the Ways and Means Committee.

The legislation is needed in order to provide consistent treatment for oil and gas with that suggested for minerals generally. In view of the recent decision of the Federal District Court for the Western District of Texas in the LaGloria Oil and Gas Company case, such legislation may also be needed to prevent substantial revenue loss.

The LaGloria case holds, contrary to the position advanced by the Treasury, that the depletion allowance in the case of natural gas is based upon the amount received for products, such as propane and butane, removed in a cycling plant rather than on the basis of the value of the wet gas at the well.

Under this decision, which is now on appeal to the fifth circuit by the Government, the depletion allowance for natural gas is increased appreciably. The implications of the LaGloria case, if upheld on appeal, could be far reaching.

For example, integrated members of the oil and gas industries might claim that they are entitled to base their depletion allowances upon the value of refined petroleum products such as kerosene, gasoline, and lubricating oils, rather than, as presently is the case, upon the value of the natural gas or crude oil in the vicinity of the well.

The draft bill takes the position that gross income for depletion purposes in the case of oil or gas is the gross income attributable to the oil or gas in the crude state in the vicinity of the well. Thus, the draft bill would codify current administrative practice of the Internal Revenue Service that depletion for the oil and gas industries is based upon the value of the crude oil or gas rather than the processed product.

I would like to submit for the record a detailed technical explanation of the draft bill which I believe will be helpful to the committee and to the industry in its consideration of this problem.

Mr. FORAND (presiding). Without objection, that will be inserted at this point. Do you also want inserted, as part of your record, these tables at the end of your statement?

Mr. LINDSAY. Yes, we would like them inserted.

Mr. FORAND. Without objection, that will be done.

(Material referred to follows:)

SUMMARY OF PROVISIONS AND DISCUSSION OF LEGISLATION TO PROVIDE DEPLETION CUTOFF POINTS FOR OIL AND GAS PRODUCERS

The Treasury proposal amends subsection (c) of section 613 by establishing cutoff points in the case of oil and gas for the computation of gross income from the property upon which the percentage depletion allowance is based.

The draft bill takes the position that gross income from the property in the case of oil or gas is the gross income attributable to the oil or gas prior to transportation from the immediate vicinity of the well and prior to conversion beyond the crude state. Thus, the draft bill would codify the current position of the Service and the administrative practice that gross income from the property is the value of the crude oil or gas rather than the processed product. The argument that certain processing does not constitute manufacturing will not be available to taxpayers under the draft bill because the draft states as a genral proposition that income from all pocessing beyond the crude state is not to be includible in determining gross income from the property.

The draft bill then sets forth methods of determining the value of the untransported crude oil or gas under various circumstances. These are as follows:

(1) If oil or gas is sold prior to transportation and conversion beyond the crude state, gross income from the property is equal to the amount for which the oil or gas is sold.

(2) If the oil or gas is sold in the crude state but is transported prior to sale—

(*a*) gross income from the property is equal to the representative market or field price for the oil or gas at the well; or

(*b*) if there is no representative market or field price at the well, gross income from the property is equal to the amount for which the oil or gas is sold minus the portion thereof attributable to transportation. The portion attributable to transportation is—

(i) if the taxpayer transports the oil or gas, the costs of the transportation plus a reasonable return on the investment in the transportation equipment, or

(ii) if a common carrier or a contract carrier transports the oil or gas, the amount paid for the transportation by the taxpayer.

(3) The draft bill contains separate provisions relating to oil which is processed beyond the crude state and gas which is processed beyond the crude state prior to sale.

(*a*) If oil is processed beyond the crude state prior to sale, gross income from the property is equal to the representative market or field price for the oil. The same rule applies whether or not the oil is transported from the vicinity of the well in addition to being processed beyond the crude state prior to sale. However, if the applicable representative market or field price represents the price that would be paid at some delivery point beyond the well rather than at the well, such price must be adjusted to remove any amount attributable to transportation to the delivery point.

(*b*) If gas is processed beyond the crude state prior to sale, the first method for determining gross income from the property is the representative market or field price as in the case of oil. However, in the case of certain types of gas, there may be no posted prices. Therefore, the draft bill sets forth alternative methods for determining gross income from the property where there is no representative market or field price. These are as follows:

(i) Under the first alternative, gross income from the property is to be determined with reference to the percentage of the selling price of the finished plant products allocated to the producer under representative contracts between gas producers and gas processors in the same general area as the taxpayer. For example, if taxpayer A is producing wet gas and processing it to obtain finished products prior to sale, and if taxpayer B who is located in the same general area is producing wet gas which he is delivering to processor C in return for 50 percent of the amount for which C sells his finished plant products, then 50 percent of the amount for which A sells his finished products will be treated as his gross income from the property. The draft bill further provides that the percentage is to be varied or adjusted, if necessary, to fit the peculiar conditions of the particular case. Thus, in determining whether taxpayer A is to use the 50-percent figure, or a greater or lesser figure, it is necessary to consider the comparability of the wet gas of A and B, whether the 50-percent figure includes any transportation which is being furnished by B, and any other such factors that indicate that A might obtain a different percentage if he entered into a contract to sell his untransported crude wet gas to a processor. The term "the same general area," as used in the draft bill, limits the area to the general geographic area in which the taxpayer is located. However, such term is not necessarily limited to the particular field in which the taxpayer is located.

(ii) If there are no contracts in the same general area as the taxpayer, gross income from the property will be computed by eliminating from the amount for which the taxpayer sells the finished products any portion attributable to transportation or conversion beyond the crude state. The draft bill provides that the portion attributable to transportation and conversion shall be excluded in determining gross income from the property in accordance with regulations prescribed by the Secretary or his delegate. It is contemplated that the regulations will conform to the administrative practice now being followed in the case of cycling plants. This practice has been to eliminate amounts attributable to processing from the amount for which the finished plant products are sold by applying the Fiske formula. Under this formula, the amount for which the finished products are sold is reduced by the costs attributable to conversion,

depreciation on equipment used in effecting the conversion, and a reasonable return on the investment in the plant in which the conversion is effected. The draft bill also provides that amounts attributable to transportation of the wet gas must be eliminated from the amount for which the finished products are sold.

In cases in which portions of the oil or gas produced by the taxpayer are sold at different stages of production, the gross income from the property with respect to each such portion will be determined in accordance with the applicable provision of the draft bill. Thus, if a taxpayer producing crude oil sells half of such oil in the crude state prior to transportation and the balance in the crude state after transportation, gross income from the property will be the sum of the amount for which the untransported crude oil is actually sold and the representative market price of the transported crude oil prior to transportation.

After setting forth the rules for determining gross income from the property where the oil or gas is converted beyond the crude state, the draft bill defines the term "conversion beyond the crude state." Such term is defined as any refining, fractionation, absorption, separation or other processing except for certain processes which have not been treated as conversion in administrative practice. Thus, under the draft bill, all processing of the oil or gas after its extraction from the ground, other than certain preliminary separating processes, is considered to be conversion beyond the crude state.

In the case of oil, when the oil is extracted from the ground, it is often not in suitable form and condition to be sold at the posted prices. It generally first goes through a mechanical separator and then to a settling or stock tank. If the oil is in a water emulsion, it may be treated with a chemical which merely helps the water to settle out of the emulsion in the tank. From the tank, the oil is generally delivered to the purchaser's pipeline as crude oil. The oil is first measured in the tank, both as to quantity and quality, and the price received is based on these measurements. Therefore, the draft bill excludes from the term "conversion beyond the crude state" those processes which are applied to bring the oil to the quality usually reflected by posted prices, that is, up to pipeline standards. Thus, if the oil goes through a mechanical separator, or if the oil is placed in a tank in order to settle out water and basic sediment, for the purpose of bringing it to pipeline standards, these processes are not considered conversion beyond the crude state. Any processes which are applied which are not necessary to bring the oil to pipeline standards constitute conversion beyond the crude state under the draft bill. This position is in accord with the administrative practice in such situations.

In the case of gas, in some instances the gas is run through a field separator when it is recovered from the ground. Under administrative practice, this process has never been considered as conversion and it is not so considered in the draft bill. The field separator is merely a simple mechanical device in the vicinity of the well by means of which some of the heavier hydrocarbons condense into liquids through reduction in pressure and temperature.

As a general rule, the administrative practice of the Service has been to consider separation by means of separators in a plant as conversion beyond the crude state. In the case of a nonintegrated operation, where a taxpayer sells his wet gas to a cycling plant operator or gasoline plant operator, such taxpayer's gross income from the property is determined to be the amount received from the plant operator. This amount is assumed to be the value of the crude wet gas as delivered to the plant operator, and thus no portion of the value added by the plant operation has been treated by the Service as includible in gross income from the property. Furthermore, if there is an integrated operator in the same general area, his gross income from the property may be determined with reference to the arm's-length agreement between the aforementioned taxpayer and plant operator. Therefore, such integrated operator's gross income from the property is based on the value of crude wet gas and does not include any amount attributable to the operation of his plant.

However, in cases where there is an integrated operator and no contracts upon which to base the gross income determination, the administrative practice has been to apply the Fiske formula as has previously been discussed. In applying this formula, separation by means of separators in the cycling plant has not generally been treated as conversion. The draft bill continues this exception.

TABLE I.—*Total potential tax loss resulting from the extension of percentage depletion to manufactured products as reflected in cases currently in litigation or pending administratively*

Mineral	Number of cases	Potential tax loss										
		Total	Unallocable by year	Allocable by year	1951	1952	1953	1954	1955	1956	1957	1958
Asbestos	1	[1]										
Bentonite	4	$422,255	$98,115	$324,140	$62,000	$25,617	$36,185	$50,579	$90,335	$37,653	$21,771	
Clay, brick and tile	80	14,428,395	1,031,819	13,396,576	1,111,190	1,062,302	1,575,466	3,139,458	2,339,058	2,609,043	1,458,302	$101,757
Clay, brick, and tile shale	2	27,639		27,639					9,294	9,732	7,925	688
Clay, fire	50	19,405,252	2,408,025	16,997,227	2,792,559	1,748,224	2,337,376	2,123,863	3,154,148	3,153,666	1,603,233	81,158
Clay, fire—brick and tile shale	10	1,843,887	39,746	1,804,141	208,215	166,065	185,800	271,989	319,860	375,276	276,996	
Coal	12	612,088	443,873	168,215			60,727	50,433		28,992	27,511	552
Coal and iron ore	2	9,566,675		9,566,675	4,403,923	[2] 2,995,769	2,166,983					
Diaspore	1	[1]										
Diatomaceous earth	2	[1]										
Dimension stone	2	37,819		37,819				24,958	12,861			
Dolomite	7	3,609,963	142,994	3,466,969	877,776	757,999	656,555	540,189	206,150	352,150	76,150	
Gilsonite	1	[1]										
Granite	7	506,511	191,000	315,511	37,285	86,229	51,666	63,316	44,439	15,696	16,880	
Gypsum	4	8,895,242	280,969	8,614,273			23,757	8,330,346	260,170			
Limestone	90	111,069,905	3,336,467	107,733,438	14,848,674	12,325,263	13,935,364	16,806,371	17,277,448	14,686,074	16,034,552	1,819,692
Limestone—clay/shale	22	84,567,281	2,694,463	81,872,818	8,124,905	12,326,284	12,507,148	12,575,815	15,122,815	11,540,485	9,455,366	220,000
Limestone and dolomite	4	881,728	881,728									
Oil and gas	6	1,476,789	18,845	1,457,944		99,641	65,666	142,497	340,047	396,598	413,495	
Quartzite	8	1,583,374	473,296	1,110,078	95,921	315,891	132,881	225,673	197,346	65,677	68,220	8,469
Rare minerals	3	527,183		527,183		546	678	22,548		253,327	250,084	
Salt	14	11,186,529	208,884	10,977,645	1,495,911	1,594,561	1,662,583	1,861,120	1,858,705	1,977,855	451,910	75,000
Sand and gravel	16	640,948	92,268	548,680	12,299	126,627	165,089	126,804	103,259	13,852	750	
Sandstone	5	245,454		245,454		55,880	59,992	66,390	32,407	21,385	9,400	
Shale	9	565,819	60,809	505,010	42,634	229,663	99,738	70,036	39,053	19,169	4,717	
Shells	2	88,656		88,656	16,095	30,052	17,800	11,481	13,228			
Stone	2	138,129	138,129									
Stone, crushed	4	847,700	538,417	309,283	35,000	67,552	68,284	72,361	66,086			
Deposits containing various minerals used in production of diverse chemical products	10	21,819,825		21,819,825	5,730,727	4,734,280	3,644,899	2,638,511	2,532,638	1,557,945	980,825	
Mineral items that cannot be disclosed		1,953,010	1,807,640	145,370	145,370							
Total	380	296,948,056	14,887,487	282,060,569	40,040,484	38,748,445	39,454,637	49,214,738	44,019,287	37,114,575	31,161,087	2,307,316

[1] Figure withheld to avoid disclosing individual company confidential data, value included with "Mineral items that cannot be disclosed."

[2] Includes $1,736,390 allocable to 1947–50.

TABLE II.—*Annual potential tax loss resulting from extension of percentage depletion to designated manufactured products for 19 mineral categories*

[All dollar figures are in thousands of dollars]

Mineral	Manufactured product or products	Depletion rate on mineral	Mineral production [1] (thousands of tons)	Value,[1] mineral	Estimated value manufactured product	Difference in value	Estimated increase in the depletion deduction[4]	Estimated tax differential [5]
Bauxite	Aluminum	[2] 23	6,743	$45,852	$716,444	$670,592	$114,001	$59,281
Bentonite	Clay products	15	1,571	18,415	55,245	36,830	5,524	2,872
Clay, brick, and tile	Brick and tile, other products	5	34,385	41,516	145,306	103,790	5,190	2,699
Clay, fire	Refractory clay products	15	11,803	53,750	208,608	154,858	23,229	12,079
Clay and shale	Cement	[3] 15 and 5	9,067	9,302	87,954	78,652	7,865	4,090
Diatomaceous earth	Filtration, filler, insulation, miscellaneous	15	250	2,282	7,740	5,458	819	426
Fuller's earth	Mineral oils, absorbent uses, other	15	418	8,879	13,318	4,439	666	346
Granite	Building stone	15	39,636	65,447	229,065	163,618	24,543	12,762
Gypsum	Building board and plaster	15	14,652	41,913	321,652	279,739	41,961	21,820
Iron ore	Steel	15	96,730	749,657	4,804,450	4,054,793	608,219	316,274
Kaolin	Paper filling and coating, other	15	2,250	34,504	51,756	17,252	2,588	1,346
Limestone	Cement	15	81,008	85,230	785,774	700,544	105,082	54,643
Limestone	Lime	15	10,577	14,660	135,727	121,067	18,160	9,443
Salt	Chlorine, soda ash	10	14,565	45,876	339,994	294,118	29,412	15,294
Sand and gravel	Road construction	5	624,697	595,101	3,570,606	2,975,505	148,775	77,363
Sandstone	Finished stone	15	13,447	33,998	46,388	12,390	1,858	966
Marl, slag, gypsum, etc	Cement	5	11,901	11,901	115,440	103,539	5,177	2,692
Stone	Rough construction	5	62,925	109,339	218,678	109,339	5,467	2,843
Talc	Ceramics, paints, filler, insecticides, other	15	739	4,859	15,026	10,167	1,525	793
Total							1,150,061	598,032

[1] Production and crude value figures are either taken directly or derived from figures in the "U.S. Bureau of Mines 1956 Mineral Yearbook."

[2] 23 percent is the depletion rate for the domestic production of bauxite. An assumed depletion rate of 17 percent is used to compute the estimated increase in depletion deduction. This is because approximately 70 percent of mined bauxite used in aluminum production is produced by U.S. manufacturers in the Caribbean area and subject to a depletion rate of 15 percent.

[3] It is assumed that equal tonnage of clay and shale is used in the production of cement; therefore, a 10-percent depletion rate is used to determine the estimated increase in depletion deduction.

[4] The figure for "Estimated increase in depletion deduction" assumes that the net income limitation does not apply.

[5] The figure for "Estimated tax differential" assumes a corporate tax rate of 52 percent.

NOTE.—Coal, petroleum, gas, and various other minerals are not represented because of insufficient data from which comparable statistics could be estimated.

TABLE III.—*Claims of individual companies illustrating potential tax loss resulting from extension of percentage depletion to manufactured products*

Mineral deposit	Mineral form claimed for depletion purposes by taxpayer	Year or years involved	Percentage depletion			Tax differential
			Computed by		Percent, taxpayer to government	
			Government	Taxpayer		
Bauxite	Aluminum sulfate (alum)	Unknown	$35,000	$232,420	664	$102,600
Bentonite	Caulking clay	do	39,600	95,400	241	29,000
	do	do	31,700	109,600	346	40,500
Clay, brick, and tile	Brick and tile products	1951–56	59,359	523,931	883	240,345
	do	1951–54	23,953	175,525	733	97,953
Clay, fire	Fire brick, mortar	1953–56	2,250,000	9,339,545	415	4,468,168
	Fire brick, structural brick	1951–53	350,000	1,773,291	507	717,220
Clay, fire, and shale	Various clay products	1951–54	44,019	537,779	1,222	250,871
	do	1951–53	9,786	123,720	1,264	66,700
Coking coal	Coke and byproducts	Unknown	140,700	258,000	183	83,100
Dolomite	Refractory brick, ground dolomite.	1955–56	312,459	844,485	270	276,549
Fullers earth	Uncertain, mineral primarily used as an absorbent or as rotary drilling mud.	Unknown	214,723	344,148	160	67,300
Granite	Building stone	1951–57	96,375	438,525	455	177,907
	Monuments	Unknown	36,173	106,553	295	36,000
Gypsum	Wallboard, plaster, and other construction uses.	do	2,125,000	12,815,000	603	6,783,900
Iron ore	Steel	Unknown	2,000,448	12,002,688	600	5,001,165
Limestone	Lime	1953–57	106,231	347,230	327	106,231
	Limestone and chemical plant (specific product unknown).	1951–53	8,064,000	37,680,000	467	19,268,000
Limestone	Cement	3 years	1,983,500	9,450,000	476	5,353,730
	do	1953–56	919,923	2,931,060	319	1,045,790
Limestone and shale/clay.	do	1951–54	3,201,678	13,702,811	428	5,760,968
	do	1951–55	1,506,248	4,009,901	266	1,020,192
Perlite	Abrasives and aggregates	Unknown	2,570	15,527	604	3,535
Quartzite	Silica	1954–55	169,035	711,523	421	288,175
Salt brine	Chlorine and caustic soda	3 years	857,874	11,555,640	1,347	6,633,876
	Salt and salt products	4 years	1,770,498	8,290,912	468	3,260,207
Sandstone	Silica products	1951–55	70,169	243,923	348	111,181
Sand and gravel	Construction use	1953–55	7,750	62,069	801	28,340
	do	do	10,315	93,935	911	43,763
Shale	Tile	1951–54	11,805	214,585	1,818	104,827
Shells, oyster/clam, etc.	Road construction	1951–53	78,612	171,620	218	63,962
Solite	Light-weight aggregate	Unknown	100,000	312,000	312	114,000
	do	do	8,080	26,779	331	8,725
Stone, crushed	Rough construction	3 years	1,730,484	3,508,283	203	924,500
	do	2 years	8,667	43,595	503	17,500

Mr. FORAND. Does that conclude your statement?

Mr. LINDSAY. That concludes my statement.

Mr. FORAND. Are there any questions?

Mr. MASON. I think there are plenty, Mr. Chairman.

Mr. FORAND. Is the gentleman seeking recognition?

Mr. MASON. I do.

Mr. FORAND. You are recognized.

Mr. MASON. As I gather the picture presented by your testimony, it appears to me that when simplified and boiled down, it means that the law as passed by Congress stating that the dollar value of the commercial product shall be the base upon which the depletion rate shall be applied and which the courts generally agree was what the Congress said.

You in your revenue rules ignored both what the Congress said should be the base for depletion and ignored what the courts said was the true law, and you in your rulings said the base shall be this point between the mining and the manufacturing. Then you tried to define

that by a lot of statements which are not very clear, because they do not apply to all industries.

Even the cement industry has different processes. You cannot apply the same to one as to the other, so, as a result of that, the industries have brought suit and tried to collect and they have found that so far the Treasury has refused to pay.

The Treasury says it is a loss to the Treasury, $300 million or $100 million, or whatever it is. How can it be a loss to the Treasury if, when the actual law is applied, it gives this depletion allowance to the industry?

How can the Treasury claim that is a loss if it belongs to the industries?

Also, the Treasury refused to return or rebate the money they have collected, not according to the law, but according to their rulings, and so now the industries have to sue to get their money back, money that belongs to them.

That is the picture as it represents it self to me, and your testimony and explanation does not change that picture as I see it.

Mr. LINDSAY. I would like first to discuss the court aspects of your question and then the legislation.

Mr. MASON. Yes.

Mr. LINDSAY. I think it is fair to emphasize that we have attempted to conform our administrative practice to the adverse decisions of three circuits, which allowed additional processes found to be customary across the Nation for brick manufacturers and cement rock. Indeed, within 4 days of the Supreme Court's denial of certiorari in several such cases, the Internal Revenue Service issued a news release in part as follows:

> The Internal Revenue Service * * * is taking steps to dispose of pending litigation in claims involving brick and tile clay and cement rock, as required under these decisions, and to conform Treasury regulations and outstanding rulings accordingly. This should permit the expeditious disposition of the great majority of such cases * * *.

Pursuant to this public announcement of policy, appropriate steps were taken with respect to all pending cases to the extent that they were governed by the appellate decisions which had been adverse to the Government as to these minerals. In these cases the appellate courts emphasized the commercially marketable mineral product as against our emphasis on the ordinary treatment processes normally applied by mine owners and operators and were dealing with deposits of a kind for which there is little or no market for the crude product.

The taxpayers were integrated operators, mining their mineral and manufacturing finished products, and most owners and operators of such deposits are likewise integrated. Moreover, the minerals do not fall readily into the present language of the statute which lists allowable processes for minerals customarily sold in the crude form and ores not customarily so sold.

Many other minerals, however, are sold in the crude form in substantial amounts. Moreover, the appellate courts have tended to read the statute as providing a cutoff at the first commercially marketable mineral product, which we believe is consistent with the purpose of the code to avoid including in the depletion base of integrated operators all the gross receipts from whatever source derived.

Much of the current litigation involves the important and difficult questions which have risen with respect to the cutoff point for integrated operators of other kinds of mineral deposits, as I indicated in my testimony in connection with the administrative difficulties resulting from the tests which the courts have applied.

Some taxpayers have urged that they should be allowed to include in the depletion base their income from all manufactured products which they market. Some have argued for income attributable to the first product that they market or the first product they might profitably market in their immediate marketing area.

These questions have not been answered by any appellate courts and so they are in litigation all over the country. At the present time, for example, the Department of Justice is handling something like 140 lawsuits, most of which involve one or more of these questions. The number of controversies is constantly growing as more and more taxpayers shift from positions taken in conformity with past administrative practice to positions claiming the applicability of the many judicial decisions in this general area of the law.

Of course, this presents administrative difficulties of considerable magnitude to the Internal Revenue Service because of the number of claims to be processed until such time as the law is more settled by amendments to the code or controlling judicial decisions or both.

I would like to add two further points:

First, during the past year there have been three appellate cases in this general area in which we have prevailed. One involved the applicability of long-standing regulations governing the measurement of "gross income from mining" in the case of coking coal mined and processed by an integrated operator in Alabama.

The other two involved efforts to include packaging among "the ordinary treatment processes" applied, respectively, to perlite and gilsonite.

It might be added that the Supreme Court denied the petitions for certiorari filed by the taxpayers in the first and third cases, but we cannot assume that the issues are resolved because they have already been raised by other taxpayers.

Finally, I want to assure this committee that we are constantly mindful of our many responsibilities in connection with tax litigation, and advise further that we have met continuing cooperation in this respect from the Attorney General, who is charged by the code with responsibility for all cases in the Federal courts.

Now, with respect to the legislation, I think it is safe to say that the statute does not in so many words apply percentage depletion to finished products. The statute is ambiguous and can be so construed because of the language in the definition of "mining."

In testimony in about 1950, a representative of the industry, arguing for a higher percentage depletion rate applied to his particular mineral, gave an example of what it would mean to his company, and his example showed the value of the manufactured product, the value of the raw material, the raw mineral or crude mineral, and the amount of percentage depletion he would receive if it was accorded to him by statute, and the figures given by him in the public record show that he assumed that the percentage depletion would apply to the crude mineral and not to the finished product.

It so happened that that person was speaking for refractory clay, therefore even at that time taxpayers had not assumed that Congress intended that percentage depletion should apply to manufacturing as well as to mining, and we have believed that that was not the intent of Congress.

Mr. MASON. What about this loss that you claim to the Treasury? You collect dollars from an industry that, according to the law, you should not collect, and now you have to return it.

Why do you call that a loss to the Treasury?

Mr. LINDSAY. Because it costs money. It has to be paid out.

Mr. MASON. However, it is not your money, so you cannot lose it. Under the law it is not your money.

Mr. LINDSAY. We speak in terms of revenue loss in any proposed legislation or development. If proposed legislation that we oppose is adopted means that the money involved does not belong to the Treasury, but to the taxpayer, it still, to the Government, amounts to a loss in revenue.

Mr. MASON. It is a loss because the Government has no authority to collect it, only in that sense; is that not true?

Mr. LINDSAY. And therefore, either cannot collect it or must refund it if it has already collected the amount.

Mr. MASON. Your bill, as I see it, seeks to give statutory authority to the rulings of the Treasury which were not, according to courts, in line with the law as passed by the Congress.

Is that not the purpose of your bill, to give statutory authority to your rulings?

Mr. LINDSAY. It would give statutory authority to some rulings which were overturned in some cases. How far this trend will go, however, is difficult to predict. It may be, in many other areas where crude minerals are sold, and there is a market for them and that market is a fact that is established before the courts, that our rulings will be upheld, but we are trying to solve this problem now by statute.

Mr. MASON. Will your bill and this new definition that you want to establish by law make any clearer cutoff dates than the present law?

Mr. LINDSAY. We believe it will. That is our intention.

Mr. MASON. You do not think that this new statute, if passed, would create an immense amount of new litigation as the old statute has done?

Mr. LINDSAY. There will be problems to be resolved under any statute that attempts to define a cutoff point, but some of the problems exist under present law other than the question of the marketable finished product.

There are problems as to how you allocate expenses and the like for determining whether or not you meet the ceiling of 50 percent of taxable or net income. Those problems exist now. They will exist under our proposed statute.

Mr. MASON. That is all for now, Mr. Chairman.

The CHAIRMAN. Mr. Boggs will inquire.

Mr. BOGGS. Mr. Chairman, I have just one or two questions.

One, Mr. Lindsay, is on page 14 with respect to the questions raised concerning the draft bill on mining. I listened with considerable interest to the statement as read and I want to raise first a specific question and then a general question. The specific question applies to the mining of sulfur.

I am informed that under the draft bill, the effect would be to discriminate against certain processes and that sulfur mines in some areas of Louisiana, for instance, would be in a different category from sulfur mines in certain areas of Texas.

Are you familiar with that problem?

Mr. LINDSAY. We did not intend to create any discrimination in the draft bill.

Mr. BOGGS. I think what happens is that you spell out certain processes in the existing law. The problem arises in the impurity content of one sulfur as compared to the other.

I call it to your attention because I am certain that it is not the intent of the Treasury to create this type of discrimination.

Mr. LINDSAY. It was not our intent.

The problem, I am told, has been brought to our attention and we agree that there should be no discrimination. It was not our intent to discriminate as between the different processes.

Mr. BOGGS. You say the problem has been brought to your attention?

Mr. LINDSAY. Yes.

Mr. BOGGS. So this will be corrected?

Mr. LINDSAY. Yes, Mr. Boggs; it will.

Mr. BOGGS. The second question, and this is a general question, is on page 15; you talk about the intervention of neutral process. How would you propose to define such a process, or do you propose to define it in the proposed statute?

Mr. LINDSAY. We propose to try to take care of this problem in the statute, working it out with industry representatives and the joint committee staff. We do not have the language ready at this moment.

Mr. BOGGS. So that this is something that you anticipate doing?

Mr. LINDSAY. Yes.

Mr. BOGGS. You mention in your main statement some of the problems arising in connection with the manufacture and processing of salt. Have you ever had any agreement with the salt industry on this percentage depletion that we gave them?

We wrote salt into the act when? In 1951?

Mr. LINDSAY. I believe that is correct, 1951.

Mr. BOGGS. Has there ever been any formula agreed on with the salt producers relative to that?

Mr. LINDSAY. I personally have not met with representatives of the salt producers. Maybe some of my associates have here.

There have been no agreements, I am advised.

Mr. BOGGS. So that this whole area has been one of, shall I say, failure to come to an understanding under the existing law?

Mr. LINDSAY. I think you could state it that way; yes.

Mr. BOGGS. You are not trying to single this particular industry out as being greedy?

Mr. LINDSAY. No; we thought it was an example of the difference between our assumptions as to what the base of the percentage depletion should be and what it might be if applied to not only salt, but salt in various sized containers.

We used other examples in the testimony, also. We were not trying to single out the industry except to show the nature of the problem with which we are faced. It is a case actually in court.

Mr. BOGGS. Involving this situation?

Mr. LINDSAY. Yes.

Mr. BOGGS. How many cases all together do you have involving these cutoff points all over the country?

Mr. LINDSAY. I think about 140.

Mr. BOGGS. In various districts and circuits?

Mr. LINDSAY. In various districts and circuits of the country.

Mr. BOGGS. Mr. Mason mentioned the fact that over the years in the determination of these allowances, if I might call them that, you have come to different conclusions in various parts of the country. I have had that situation brought to my attention by some of these groups. In my State we produce most of these things: Salt, sulfur, oil and gas, and shells, brick, tile, and cement.

Will this statute correct that situation or will you still have a revenue office in one area coming up with one conclusion and another one coming up with another one?

Mr. LINDSAY. I would hope that this statute would correct that situation and, with respect to one particular mineral, the same cutoff point would be allowed all over the country.

If you look only to a marketability test, which is now suggested by the existing statute and applied by some of the courts, there would definitely be discrimination if local market area were the test as to marketability as opposed to a national marketing area.

Mr. BOGGS. It has been suggested by some of the industry people that the language as proposed in the statute would not settle litigation and might actually create new litigation. Would you think there was any validity to that contention?

Mr. LINDSAY. I certainly am not in a position to say that there would be no litigation under the statute, and we would want to cooperate with the congressional staffs and with industry representatives to try to produce a statute that would produce as little litigation as possible.

Mr. BOGGS. So that you are not wedded to the language in the draft?

Mr. LINDSAY. No; not at all.

Mr. BOGGS. That is all, Mr. Chairman. Thank you.

The CHAIRMAN. Mr. Curtis will inquire, Mr. Lindsay.

Mr. CURTIS. Mr. Lindsay, I am interested in the basic considerations here. That is the way,I think, to get at it. I refer to your testimony on page 9, where you refer to the various rates that range from 5 to 27½ percent, and you say:

> These varying rates reflect the considered judgment of Congress that in the light of all the circumstances, certain minerals should receive a higher rate of depletion than others.

Throughout your statement nowhere do I find an expression of the basic philosophy which gives rise to depletion tax allowance at all. Essentially, the reason depletion is allowed is because of the constitutional restrictions upon taxing only income. Am I not right?

In other words, we cannot under the Constitution tax capital, and we are attempting to figure out what is return of capital so that we do not tax that; am I correct?

Mr. LINDSAY. I think that is correct with respect to cost depletion. Percentage depletion first came in in 1926 to replace another type of thing which was called discovery value depletion.

Mr. CURTIS. That is correct.

In other industries, if it is machinery you can replace it, so your discovery depletion is the cost involved in replacing that capital asset. Therefore, it is still, is it not, the philosophy based upon the conception that we are trying to avoid taxation of what might be considered in the term "capital"?

Mr. LINDSAY. I think again that that is true with respect to cost depletion, but not percentage depletion.

We cited *Helvering* v. *Bankline Oil Company* at pages 3 and 4 of the testimony, and I might quote from that case to see how percentage depletion was viewed by the Supreme Court at least in that case:

> In order to determine whether the respondent is entitled to depletion with respect to the production question, we must revert to the fundamental purpose of the statutory allowance. The deduction is permitted as an act of grace. It is permitted in recognition of the fact that the mineral deposits are wasting assets, and it is intended as compensation to the owner for the part used up in production. The granting of an arbitrary deduction, in the case of oil and gas wells, of a percentage of gross income was in the interest of convenience and in no way altered the fundamental theory of the allowance.

By stating the matter of legislative grace, I think the inference is that the deduction is not a constitutional question, because you are recovering more than cost in many cases.

Mr. CURTIS. That is what I am getting at.

In order to understand what you are presenting here, we have to go back and touch this base of what we are really doing. It is a question of whether or not it is a subsidy or whether or not this is an attempt to measure something that is quite difficult to measure with the physical and economic factors involved, to measure what actually is the capital investment and how we can accurately measure the return. That is why I think the statement the gentleman read actually does conform to what I have said. The added feature that you mention of percentage depletion came in when the theory was advanced that not only do we have to try to estimate what the return of capital is involved in, say, a body of ore, but if the concern that has that body of ore is to remain as a mining concern, it has to find another body of ore. Just as a textile company would have to replace its textile machinery if it was going to remain in business.

I do think it is important that we get this philosophy out in the open, because underlying all of this is the question of whether or not Congress is actually trying to subsidize or is Congress trying to measure a very difficult area of what is a fair estimate of what the return of capital should be.

In your statement you say that in light of all the circumstances the Congress decided certain minerals should receive a higher rate of depletion than others. I think the circumstances were, and I hope they were, where Congress attempted to measure what is a proper return of capital in this area.

This comes to the next question, and perhaps if I pose the questions maybe we can develop some testimony along this line. Inasmuch as Congress set these varying rates at the time they did, they also had in mind when they set them the cutoff place in the then processing that went on in that particular mineral. Congress set that on the basis of what they thought was reasonable, and the rate and the cutoff process are interwoven to try to accomplish this end result. So

the basic question I come to is: Do you think we can intelligently consider changing the cutoff place without at the same time reviewing our percentages?

Mr. LINDSAY. We had not undertaken ourselves to review the broader aspects of percentage depletion in connection with this legislation.

Mr. CURTIS. I know you have not. That is why I have raised the question.

In light of this and knowing that that is the way Congress has set these varying percentages on a cutoff place at a particular time that they then thought was reasonable, and that therefore the percentage figure is interwoven and cannot be removed from the percentage, the question I pose is: Can we intelligently take this up piecemeal as the Treasury is asking us to do and just consider changing the cutoff place without at the same time considering the percentage?

Mr. LINDSAY. I think it is possible to look at the cutoff problem separately from the rates, although ideally perhaps you are correct that they should be looked at together, but basically, if the percentage depletion is as I have described, to compensate the owner for the exhaustion of the minerals in the ground, it should be applied to the value of the mineral and not applied to the value of a manufactured product.

The general philosophy of the cutoff point in this bill is to permit the percentage depletion allowance to be based on the value of the mineral as it comes out of the ground, plus processes necessary to separate out waste materials.

Mr. CURTIS. I agree, I might say, with that point of view.

What I was saying, to get back to the philosophy behind it, Congress has always been confronted with what goes on in a particular industry. If it is clay, how has clay been processed and where is the logical cutoff point?

There is no really sure place to cut off. You have to use a reasonable judgment, but Congress then, in using its judgment, indicated—I hope we did this and I am not saying we did because I think a lot of subsidy can come into these things—this was on the basis of not trying to give any subsidy at all.

If we figured that from an administrative standpoint because of the way the industry was run and it developed that your cutoff point was here, then we went back and looked at what were we fundamentally trying to do, which was not to tax capital. We then set our percentage figure. So if you ask us in light of modern developments and technology to change our cutoff spot on any mineral, I think if we are going to do an adequate job we are going to have to take a look at the percentage figure. Maybe we should take the Treasury's proposed rule, which I agree with, I might say, because what we are trying to do is measure the ore body, we might have to increase some percentage figures.

Therefore, this talk of the Treasury loss of revenue should not be the real thing involved here. The real thing should be, are we accurately and intelligently measuring the return of capital? Or if Congress wants to we can subsidize by having a higher percentage.

Of course, if we subsidize any of these minerals, I want it out in the open. I think all the industries should want to have it out in the

open. I think all the industries should have it out in the open if there is any subsidy. Otherwise, they are going to be subjected to what they are being subjected to now, a lot of loose talk that this is a subsidy, instead of actually a return of capital.

Mr. GLASMANN. Mr. Curtis, if I may supplement Mr. Lindsay's answer to you, the present definition of mining in the statute was for the most part added back in 1943 with its cutoff points about what they are now. At that time when Congress enacted the 1943 law, it thought that it was simply enacting the past practices of the Service, so that we feel that the courts have gone far beyond the congressional intent in this cutoff area. All we are asking is to push back to the point that we think Congress had in mind when it passed the 1943 law.

Mr. CURTIS. I know your point, but I am thinking of it from our point.

I think if we review one aspect of this formula, if we are going to do the right kind of job, we have to review the whole formula.

Mr. Chairman, I would like to ask if the Treasury would prepare a statement on what their philosophy is on percentage depletion.

Have we in Congress indeed deliberately been trying to subsidize, or have we been trying to measure as best we can a very difficult thing, which is a return of capital so we do not tax it?

Let's get our philosophy straight. I do not want an industry accused of being subsidized when in reality it is not so.

On the other hand, if they are, let's find out how much. I might agree we are subsidizing them.

Mr. LINDSAY. We will prepare a statement and submit it for the record. It may not be definitive.

Mr. CURTIS. Thank you.

Mr. FORAND (presiding). It will be included in the record at this point, without objection.

(Material referred to follows:)

PURPOSE OF PERCENTAGE DEPLETION ALLOWANCE

A study of the legislative history of the depletion allowance reveals an intent on the part of Congress to grant a depletion allowance which exceeds cost depletion in order to create an incentive for exploration and development of the mineral resources of the United States.

The Revenue Act of 1916 provided for depletion based on cost or on March 1, 1913, value of the property. The Revenue Act of 1918 introduced the concept of discovery depletion. This concept permitted the depletion deduction to be computed with reference to the fair market value of the property at the date of discovery or 30 days thereafter. Statements in the committee reports accompanying the Revenue Act of 1918 and the Congressional Record, while not entirely definitive, indicate that a primary purpose of the discovery depletion allowance was to furnish an incentive to encourage exploration.

In describing certain other liberalizing provisions of the 1918 Revenue Act affecting natural resources taxation, the committee report of the Senate Finance Committee stated, "To stimulate prospecting and exploration, the committee has limited the surtax to 20 percent of the selling price in the case of a bona fide sale of mines, oil or gas wells where the principal value was demonstrated by prospecting, exploring, or discovery work done by the taxpayer" (S. Rept. No. 617, 65th Cong., 3d sess., Dec. 6, 1918). This explanation was not repeated in the report with reference to the new discovery depletion provision, but it is believed that the statement "to stimulate prospecting and exploration" was equally applicable to the allowance of discovery depletion in view of the context in which it appeared. For support of this conclusion, see the report "Legislative History of Depletion Allowances" prepared by the staff of the Joint Com-

mittee on Internal Revenue Taxation, March 1950, at page 2. Further, in explaining the new depletion provisions on the floor of the Senate, Senator Penrose, the ranking Republican member of the Senate Finance Committee, stated, "In pursuance of a policy permitting * * * the development of new resources * * * they (the depletion provisions) also provide for a more liberal allowance than heretofore permitted in the case of newly discovered mines, or oil or gas wells, permitting the deduction to be based on the fair market value of property discovered instead of its cost" (57th Congressional Record 549, 65th Cong., 3d sess.).

In 1926, the Select Senate Committee on Investigation of the Bureau of Internal Revenue stated in its partial report, "It is very clear that the purpose of the provision for discovery depletion was to stimulate prospecting for new deposits of mineral and oil * * *" (S. Rept. No. 27, 69th Cong., 1st sess., p. 3, January 1926). The Revenue Act of 1926 provided for percentage depletion in the case of oil and gas wells in lieu of discovery depletion. This change was made in the interest of simplicity and certainty in administration, and there was no announced change in the basic intent of Congress so far as the depletion allowance was concerned (see S. Rept. No. 52, 69th Cong., 1st sess., January 16, 1926).

In 1932, percentage depletion was substituted for discovery depletion in the case of coal, sulfur, and metal mines.

Percentage depletion was retained and was made applicable by Congress to additional groups of nonmetallics in the Revenue Acts of 1942 and 1943. The extension of the percentage depletion allowance to the additional minerals in 1943 was to be for the duration of the war only. See section 124(e) of the Revenue Act of 1943 which provided for the termination of percentage depletion in the case of certain minerals. However, in 1947, this extension of the percentage depletion allowance was made permanent in section 15 of H.R. 4069, 80th Congress. In explaining this provision on the floor of the House, Representative Knutson stated, "it (percentage depletion) is given to compensate, partially at least, those taxpayers engaged in such mining operations, for the cost of discovering new sources of these products and thus encouraging their production * * *. The one exception (to the termination of certain wartime exemptions) is the percentage depletion allowance which we have learned is essential to full utilization of our resources both in peacetime as well as in war" (93 Congressional Record 9628, 80th Cong., 1st sess.).

In 1951, and again in 1954, percentage depletion was extended to additional minerals. Percentage depletion now applies to all minerals except "soil, sod, dirt, turf, water, or mosses" or "minerals from sea water, the air, or similar inexhaustible sources" (Sec. 613(b)(6)(A) and (B) of the Internal Revenue Code of 1954).

In a report to the President entitled "Resources for Freedom" by the President's Materials Policy Commission in 1952, minerals tax policy was discussed. According to this report, percentage depletion performs two principal functions. These functions are (1) the stimulation of discovery and development of additional reserves of scarce critical minerals for which exploration entails considerable uncertainty and capital risk, and (2) the recovery of investment in a wasting asset. The report concludes that where the mineral is scarce or the national need is great, there is justification in permitting a higher percentage depletion rate than would be necessary if recovery of capital were the sole objective.

From the foregoing discussion, it is apparent that the percentage depletion allowance was provided by Congress not only to permit recovery of the investment in the wasting asset but also to provide incentives for exploration necessary for replenishment of the wasting asset by the discovery and development of additional deposits.

A sound national policy must, of necessity, provide for the development and replenishment of all our vital mineral resources as a part of our economic arsenal to insure our security and to provide for growth and expansion. Only in this manner can we provide the goods and services in peacetime requisite to our national development and to provide work opportunities for an expanding labor force and for the best use of technological developments. Such a policy requires that we develop such resources at a rate that will, on the average, exceed the rate of domestic demand. Only then will we have a margin which can be used should we be confronted with emergency demands either for our own use or for that of our Allies.

The philosophy of percentage depletion must, therefore, be properly examined not only in the context of our overall tax structure but in the light of such national considerations as those suggested.

Such appraisal must include an examination into the whole fabric of percentage depletion allowances which cover not only oil and gas but practically all other minerals, metallic and nonmetallic alike, to which over the years the Congress has made the percentage depletion provisions applicable.

Mr. HARRISON. Mr. Chairman.

Mr. FORAND. The gentleman is recognized. Mr. Harrison will inquire.

Mr. HARRISON. Mr. Lindsay, is the Treasury draft intended to affect the present methods of computing depletion allowances on coal?

Mr. LINDSAY. No; I don't believe it is.

Mr. HARRISON. The answer, I assume, then is "No"?

Mr. LINDSAY. No.

Mr. HARRISON. Is it intended to eliminate depletion based on presently allowable mining processes performed by mine owners on their own coal which, however, is extracted by independent contractors?

Mr. LINDSAY. It does not get into the question at all.

Mr. HARRISON. In the draft bill flotation, one of the processes used in the preparation, for example, of manganese ores for marketing is listed as an allowable process. Pulverization, burning, furnacing, sintering, nodulizing also are listed as allowable processes, but only with respect to certain minerals, not including manganese.

Inasmuch as these processes are customarily used in the preparation of certain manganese ores for marketing, why are they not listed as allowable for manganese, or to put it the other way around, why are these processes allowed for a few specified minerals?

Mr. LINDSAY. Because they were in the existing statute.

Congress expressly provided for those processes for certain minerals and we did not feel that we should go further in this legislation than attempt to cut back on the court decisions that have gone beyond what we thought the statute specified.

Mr. HARRISON. Is there any reason for such distinction?

Mr. LINDSAY. There must have been a reason for it at the time it was introduced in the statute.

Mr. HARRISON. You do not know what it might be? Would you mind making some inquiry and let me know, for the record. I ask that he be allowed to amplify his answer as to the historic reason for a distinction between manganese ore and other ores.

The CHAIRMAN. Let's have this understanding generally about this testimony; that if Mr. Lindsay or any other witness in the course of this hearing is requested by a member of the committee to amplify his statement for the record, he may have that privilege.

Mr. HARRISON. I will be grateful, Mr. Lindsay, if you would send me a copy of what you put in the record.

Mr. LINDSAY. Yes, Mr. Harrison.

(Material referred to follows:)

SPECIFIC PROVISIONS FOR QUICKSILVER, TALC, MAGNESITE, AND PHOSPHATE ROCK

By section 1(b)(3)(D), the proposed bill would specifically allow furnacing of quicksilver, pulverization of talc, burning of magnesite, and sintering and nodulizing of phosphate rock.

This follows the pattern of existing law, which defines allowable and unallowable processes in general terms and also sets forth these specific provisions. The only change is to group these provisions in a single subparagraph.

The provisions were added by Congress at various times. Furnacing of quicksilver was added to the 1939 code by the Revenue Act of 1943. The other three were added in the 1954 code.

The processes for quicksilver, talc and magnesite were also the subject of court decisions, namely, *New Idria Quicksilver Mining Co.* v. *Commissioner*, 144 F. 2d 918 (1944); *International Talc Co.*, 15 T.C. 981 (1950); and *Northwest Magnesite Co.* v. *U.S.*, 1958–1 USTC par. 9394 (ED Wash., 1958).

It should be noted that such processes are allowable to other mine operators under the proposed bill (section 1(b)(3)(C)) if they are required for beneficiation by concentration, or necessary to bring the mineral or ore to form and condition suitable for shipment.

TREATMENT PROCESSES APPLIED TO MANGANESE

Under the Internal Revenue Codes of 1939 and 1954, manganese mines were considered to come under the general term "metal mines," and as such all the processes normally applicable to metal mines were considered equally applicable to manganese mines.

We are informed that in nearly all the manganese mines in the country, the ore is crushed and ground fine enough to release the manganese minerals, and then concentrated, and the concentrates may be agglomerated to prepare for shipment to a smelter or to a Government stockpile. There does not appear to be anything in these processes to distinguish a manganese mine from any other metal mine which amalgamates its concentrates before shipment.

We understand that one producer roasts or calcines its ores in the process of concentration. The wording of section 613(c)(3)(C)(ii) and 613(c)(4) in the proposed amendment is intended to cover such a situation. Proposed section 613(c)(3)(C)(ii) reads: "(ii) beneficiation by concentration, *and the processes necessary thereto.*" [Emphasis supplied.] Proposed section 613(c)(4) reads, in part: "The following treatment processes shall not be considered as 'mining': (A) In the case of all minerals or ores * * * roasting, calcining * * * *unless such processes are otherwise provided for in paragraph (3).*" [Emphasis supplied.]

We believe, therefore, that the processes applied to manganese are adequately provided for in the draft of legislation, and that it is neither necessary nor desirable to single out manganese in the code as an exception from the general rules applicable to other metal mines.

Mr. LINDSAY. I might just add that flotation is one of the many types of processes of separating waste from the mineral and that generally we regard it as a mining process and it has been generally so regarded as a mining process.

Mr. HARRISON. It is a fact, is it not, that manganese now being bought in the form of ore by the Federal Government under the purchase program in the General Services Administration, includes, without any distinction as to price, lump ore in a natural state and in the language of the purchase program, nodules or sinters densely agglomerated by application of heat.

That is true, is it not, or do you know?

Mr. LINDSAY. I do not personally know.

Mr. HARRISON. Where under the Treasury's draft would taconite ore be treated?

Mr. LINDSAY. Taconite is a form of crude iron ore. We have a provision which applies in the case of all other minerals or ores, other than the ones already specified:

Where applied to crude minerals or ores—crushing, grinding, sorting, screening, washing, and drying to remove free moisture, beneficiation by concentration, and the processes necessary thereto—

and then there is a provision:

Any additional process, if necessary, to bring the mineral or ore to form and condition suitable for shipment.

The CHAIRMAN. Mr. Baker will inquire.

Mr. BAKER. I am disturbed in this field as well as other areas of the tax field at the lack of uniformity in interpretation throughout the Nation, and I know you are disturbed about the same field, and this committee has done a lot of work.

Under existing law, are there various interpretations as to specific minerals and ores throughout the Nation?

Mr. LINDSAY. I suspect there are.

Our attempt is to eliminate that as much as possible.

Mr. BAKER. Why is it that central authority here cannot issue—I am not talking about rulings in particular cases—interpretations and regulations that these various district people can and will follow?

Is it just humanly impossible to do that?

Mr. LINDSAY. We are trying to do that as best we can. When the test for percentage depletion is based on marketability, as it appears to be at least for certain minerals, on marketability of the finished product, it is pretty hard to achieve uniformity where there is a market, say, in the eastern seaboard and no market on the west coast.

Mr. BAKER. This law was passed in 1954. Has the Treasury issued regulations as to each segment involved in percentage depletion?

Mr. LINDSAY. The proposed regulations are out in notice form in large part and they have been out in notice form for some period of time. We have met with industry representatives. There have been many disputes with respect to portions of those regulations and we are doing our best to bring them in final form.

Some of the changes suggested are of such magnitude that we may have to issue the changed regulations as a new proposed regulation rather than as a final regulation.

Mr. BAKER. It has been 4½ years since H.R. 8300 became the law. If these two bills should be enacted into law, you would have to have new regulations as to every section and every segment, would you not?

Mr. LINDSAY. Yes, and we think the regulations would be easier to develop under the proposed bills.

Mr. BAKER. How long would it take the Treasury to have new regulations if these two bills should be enacted into law?

Mr. LINDSAY. I hesitate to predict how long it would take to produce the regulations, but every effort would be made to get them out with dispatch.

Mr. BAKER. I am not in any sense indicating my position on these two bills, but it looks to me that you may have much, much more litigation.

Would you propose to make these statutes retroactive?

Mr. LINDSAY. No, prospective.

Mr. BAKER. You would continue, then, all the litigation you have now under the 1954 code. These would not, of course, affect that.

Mr. LINDSAY. Not for past years.

Mr. BAKER. And those decisions would not be any guidelines after the effective date of the proposed statute?

Mr. LINDSAY. No; they would not.

Mr. BAKER. They would not be a guideline at all?

Mr. LINDSAY. We hope to provide the guidelines in the statute on this question of cutoff.

Mr. BAKER. Do you think in regard to any tax legislation presented to the committee it would be possible for the Treasury to submit with the proposed legislation proposed regulations for the committee to consider? Then we would know what you were doing.

That is what I am driving at. We would know how you would interpret. Would that be a fundamental approach that might hit the heart of the whole problem?

Mr. LINDSAY. It might be a very ideal approach, but it is difficult enough to complete the regulations under statutes that have been passed, much less to provide and develop regulations under statutes that are proposed and may not be passed.

I might say that much additional and helpful material in connection with any statute is found in the committee reports and, generally speaking, persons in the service who are expected to carry forward and work on the regulations help in the development of those committee reports which themselves are almost junior regulations.

Mr. BAKER. If Mr. Mason's line of inquiry is correct, apparently the Treasury did not pay much attention to the committee report in this particular field.

Mr. MASON. That is right.

Mr. BAKER. I am not sure about that. I have not studied the committee report.

I yield to Mr. Simpson.

Mr. SIMPSON. I want to ask you, Mr. Baker, if you would inquire whether perhaps there are regulations already prepared on this legislation.

Mr. BAKER. I would like to know that. In fact, that goes back to my question of just 2 or 3 minutes ago, and Mr. Lindsay said the ideal way to legislate would be if we had regulations before us, so are proposed regulations prepared at the Treasury on these proposed statutes?

Mr. LINDSAY. No. We had all we could do in this area in trying to develop the statute. In further developing the statute and in working on the statute with various other persons, with the congressional staffs and with industry representatives, further problems will develop and we will get more know-how, all of which will make it easier to develop regulations.

Mr. MASON. These bills, as I understand them, are to validate the regulations that have already been issued which were not based upon the law as passed by the Congress.

Mr. BAKER. I do not know that I entirely agree with Mr. Mason, but you might say that, and say further, as I gather your position, that the bills would be to solve past statutes or to adopt by statute the position taken by the Treasury in the courts and otherwise.

Is that a fair statement?

Mr. LINDSAY. That is correct.

Mr. BAKER. I am concerned about that Supreme Court decision you read a while ago about percentage depletion being an act of grace. I have not read that decision.

Is that about all they said about that, that it is an act of grace; it is a bounty; you reach up in the air?

Mr. LINDSAY. It also stated it would compensate the taxpayer for the exhaustion of the minerals in the ground.

Mr. BAKER. Speaking as a lawyer, are not those two terms completely contrary to each other?

If you are going to compensate the taxpayer for loss of actual resources as being an incentive to find other sources of natural resources, then that is not an act of grace, it does not seem to me.

Mr. LINDSAY. The courts have constantly stated that all deductions are a matter of legislative grace. You get into the constitutional question when you tax gross receipts and do not allow for cost of goods sold, so to speak. Certainly, at least, cost depletion would include cost of goods sold. Whether percentage depletion going beyond cost depletion does or not is a matter on which many people differ.

Mr. BAKER. Going back into the history of the subject, I agree thoroughly with Mr. Curtis that if we are going to really solve this problem we are going to have to look to rates. That may be a disturbing statement, but how long has it been, as a matter of legislative history, since there have been hearings by this committee on rates?

Mr. LINDSAY. In 1951 there were extensive hearings on rates, were there not?

You gentlemen know better than I do on that. In 1954 I believe there were further hearings.

Mr. BAKER. Those hearings apparently were only for placing what was added to the code into law.

As I understand you, a while ago, the term "percentage depletion" as such first went into basic law in 1926.

Mr. LINDSAY. That is right.

Mr. BAKER. What was it known as before that?

Mr. LINDSAY. There was a provision called discovery value depletion, I believe.

Mr. BAKER. And as a matter of legislative history, did that provide a conglomeration of rates like we have now, percentage depletion?

Mr. LINDSAY. I believe it was the intent of Congress when they established the rate of 27½ percent for oil and gas to roughly equate the depletion deduction with discovery value depletion. Discovery value depletion was very difficult to administer and created many controversies.

Mr. BAKER. Now percentage depletion is statutory language.

Mr. LINDSAY. That is correct.

Mr. BAKER. I always understood that one of the basic reasons for percentage depletion was to encourage the mineral industries to plow money back into discoveries to find new fields so that natural resources would not be depleted when they are so needed in the national interest. That has been my understanding of the basic reasoning behind percentage depletion.

Am I wrong on that concept?

Mr. LINDSAY. No; I think you are correct, Mr. Baker.

Mr. BAKER. That is really the basic reason?

Mr. LINDSAY. Yes.

Mr. BAKER. In the statement you have given the classic example of oil and gas, if I may mention that term. I do not even see any

member of the committee looking up when I say that. I have always heard that the high percentage was due to the fact that even in a proven field, the highest field, if you get one well out of five, or something, you are doing well. That is what I heard.

Mr. IKARD. One out of ten.

Mr. BAKER. Or 1 out of 10.

Then under the theory advanced by my colleague, Mr. Curtis, for whom I have the highest regard, and contrary to the language "act of grace" by the Supreme Court, if we are going to explore this thing further we ought to do it right, and understand what we are doing. I think the public ought to know what is back of it.

Has the Treasury in recent years, to your knowledge, or since 1926 when it went into law, made any recommendations ratewise?

Mr. LINDSAY. Yes, I believe the Treasury has, in specific instances in 1942 or 1943, and in 1950. I do not believe there have been any specific recommendations since 1952.

Mr. BAKER. I had heard before these hearings started, through the Treasury sources or otherwise, or in the committee, that you had some more glaring instances than you set out in your very fine testimony on this cutoff proposition. I am back to that now. I think it would be helpful if there are such instances.

I believe it was said once that it could run into a thousand percent, or 2,000 or 3,000 percent in some conceivable instances.

Do you have any such instances as that there?

Mr. LINDSAY. In our testimony and in the tables attached, we try to show all those of which we are aware.

Mr. BAKER. It seems like somebody mentioned optical lenses in some hearing we had. Maybe it was in executive session.

Do you have instances set out in the tables which are specific?

Mr. LINDSAY. In the tables we try to show all the examples that we know of.

Mr. BAKER. In conclusion, my biggest concern at the moment is, are we going to resolve the question by these bills, or are we going to plunge the entire field into really a forest of chaos of litigation.

You have given it a lot of thought apparently. You think you resolve it, No. 1, as I get your testimony, by taking a specific allowable instance, and No. 2, specific disallowable instances.

Mr. LINDSAY. That is correct.

Mr. BAKER. Rather than the language of paragraph (2) at the bottom. Am I right about that?

Mr. LINDSAY. That is right.

Mr. BAKER. That language in paragraph (2) defining mining in itself would not do the job?

Mr. LINDSAY. No, you would have to look to the treatment processes.

Mr. BAKER. However, you do think that will be an improvement over existing law or you would not have it in there.

Mr. LINDSAY. Very definitely, and I think this is an opportunity to try to improve existing law and to find a solution. It may be that you disagree with our attempted solution in the draft and maybe we can improve it, but we do know that we have a problem now, a very real and difficult problem.

Mr. BAKER. That is all, Mr. Chairman.

The CHAIRMAN. Are there any further questions?

Mr. Herlong will inquire.

Mr. HERLONG. Mr. Lindsay, I was wondering what kind of study was made of the more than 50 extractive industries in this country to determine which of those processes would be classified as mining and manufacturing preparatory to the drafting of this bill?

Mr. LINDSAY. An examination of the cases, an examination of the administrative practice, including inquiry in the field offices, and examination of all the rulings and the legislative history was made.

Mr. HERLONG. Is it true that your bill is going to require mine owners to engage in very elaborate cost accounting operations to determine the gross income, and that this comes about because your bill arbitrarily provides in effect that mining industry income falls well before any salable product is reached?

Mr. LINDSAY. Any time you apply percentage depletion to a point before you reach the salable product, you have a problem of allocation.

Mr. HERLONG. I am particularly concerned with cement, because there are some cement plants in my district and I know, as you know, that there are plants that are able to operate more efficiently than others.

I am speaking of their prekiln cost. I am wondering if your bill would not operate to give an unfair advantage to those who operate less efficiently in their prekiln operation.

You understand what I mean by that?

Mr. LINDSAY. Yes; I see what you mean.

Our bill does not provide how you would allocate expenses any more than the existing statute provides for an allocation of such expenses.

Mr. HERLONG. It would provide that they would get a percentage of depletion based on the prekiln cost, would it not?

Mr. LINDSAY. Yes.

Mr. HERLONG. And if one had a higher prekiln cost than another by reason of inefficient operation, he would get a premium for being inefficient, would he not?

Mr. LINDSAY. That would be true also in the finished product if there were higher costs, although I believe that percentage depletion is based not on the cost so much as on the gross income from the product, so it really is the gross income we look to.

Mr. HERLONG. Would your bill make for artificial business practices on the part of miners in order to avoid disallowance of mining processes just because they come after nonmining processes?

Mr. LINDSAY. I would doubt it.

I think the present trend in the court decisions would encourage integration of producers and manufacturers.

Mr. HERLONG. Thank you.

The CHAIRMAN. Mr. Knox will inquire, Mr. Lindsay.

Mr. KNOX. Mr. Lindsay, in your reply to Mr. Harrison's question relative to taconite ore, did I understand you correctly that the treatment in the separation of waste from minerals is defined as mining in the Treasury draft?

Mr. LINDSAY. That is correct.

Mr. KNOX. Thank you.

The CHAIRMAN. Are there any further questions?

Mr. Ikard will inquire.

Mr. IKARD. Mr. Lindsay, in replying to some questions that have already been asked you, I assume that you would agree that the ra-

tionale for the whole idea of percentage depletion is to provide first some sort of measure for the consumption of capital assets, and secondly, to encourage the development of our natural resources.

Is that a fair statement?

Mr. LINDSAY. Yes, I think it has that dual purpose.

Mr. IKARD. The statute provides, as we all know, for certain rates for particular minerals.

As I understand it, your principal quarrel with the present statute is not in respect to percentage rate, but with this so-called point of marketability, where a market is established.

To pursue a line of questions that Mr. Curtis, I believe, raised a few minutes ago, how can we really divorce the rate question from this question of cutoff?

It would seem to me, while I was not a member of this committee at the time, that the Congress must have taken into consideration when they established these rates, that this is, in a sense, a measure of the using up of a capital asset. They must have considered necessarily in determining a given rate for a given mineral, when they included manufacturing processes, say, in the case of brick, or title, or whatever it might be, that the percentage decided on took care of the measure of the consumption of the raw product even though the manufacturing process was in there.

When you make a recommendation such as has been made here today, are you not in effect changing the whole philosophy?

Mr. LINDSAY. I don't believe so, and I think that the legislative history shows that at least in 1950 the rates for clay were expected to be applied to the crude clay and not to finished bricks.

I think we can demonstrate that with a further statement which I will add in the record at this point, with your permission.

Mr. IKARD. I would be very interested in seeing any expression of congressional intent that would bear that out.

As I say, I was not here myself so I speak only from hearsay, but I have some evidence to the effect that Congress intended just the contrary. I think that becomes of some importance here and I would like very much to have any statement for the record that you could furnish us on that point.

(Material referred to follows:)

LEGISLATIVE HISTORY AS TO CUTOFF POINT

The Income Tax Act of 1913 (section 11G(b)) provided, in the case of mines, for a reasonable allowance for depletion of ores and all other natural deposits, not to exceed 5 per centum of the gross value at the time of the output for the year for which the computation was made. Treasury Regulations 33 defined "gross value at the mine" to mean the market value of ore, coal, crude oil, and gas at the mine or well.

Under the Revenue Act of September 8, 1916, there was authorized in the case of mines, a reasonable allowance for depletion, not to exceed the market value in the mine of the product thereof which has been mined and sold during the year.

The Revenue Act of 1918 first allowed depletion based upon discovery value and this method of computing depletion was carried over into ensuing acts with certain modifications through the years. Treasury Regulations 62 provided that if the mineral products were not sold as raw material but were manufactured or converted into a refined product, then the gross income was assumed to be equivalent to the market or field price of the raw material before conversion.

The discovery depletion provisions presented serious administrative difficulties, particularly in the case of oil and gas wells. Congress, in 1926, enacted the percentage depletion provisions, allowing 2½ percent of the gross income from the property in the case of oil and gas wells as the depletion allowance. This change was made in the interest of simplicity and certainty in administration, and there was no announced change in the basic intent of Congress so far as the depletion allowance was concerned. See S. Rept. No. 52, 69th Cong., 1st sess., January 16, 1926.

Treasury Regulations 74, article 221(i), promulgated February 15, 1929, included a specific definition of gross income from the property for the first time as follows:

"If the oil and gas are not sold on the property but are manufactured or converted into a refined product or are transported from the property prior to sale, then the gross income shall be assumed to be equivalent to the market or field price of the oil and gas before conversion or transportation."

This definition, which is similar to that included in Treasury Regulations 62, and others before it, merely carried over into this new concept of valuation (percentage of gross income from the property), the basic rule that mining and manufacturing operations cannot be combined to raise "gross income" to a figure higher than the value of the basic mineral product. This definition was held to be a proper implementation of the statute and its validity has been sustained throughout the years (*Brea Cannon Oil Co.* v. *Commissioner*, 77 F. 2d 67 (C.A. 9th), certiorari denied, 296 U.S. 604; *Greensboro Gas Co.* v. *Commissioner*, 79 F. 2d 701 (C.A. 3d), certiorari denied, 296 U.S. 639).

Congress, in the Revenue Act of 1932, extended percentage depletion to coal, metal mines, and sulfur. In connection with consideration by Congress of the extension of the percentage depletion allowance to mines, a preliminary report on depletion dated September 9, 1929, was prepared by the staff of the Joint Committee on Internal Revenue Taxation. Also, extensive hearings on depletion of mines were held before the Joint Committee on Internal Revenue Taxation in December 1930 and the subject was also discussed at hearings before both the Committee on Ways and Means and the Committee on Finance prior to the enactment of the Revenue Act of 1932.

During the hearings and in the testimony presented by interested parties, the fact was brought out that the Treasury regulations which implemented the earlier statutes required, in effect, the separation of mining and manufacturing operations so that "gross income from the property" would properly reflect only the gross income from mining. Since Congress was aware of this long-standing administrative practice, and did not include a definition of gross income from the property in the Revenue Act of 1932, it is proper to conclude that Congress intended that the existing practice be continued. In this respect, witnesses who requested a 27½ percent depletion allowance for the sulfur industry testified at the hearings on the revenue bill of 1932 that sulfur is in its commercial state as recovered and has a field price as it comes out of the ground. Unlike metals, no smelting, concentrating, refining, etc., was necessary and, therefore, the witnesses stated, percentage depletion was particularly appropriate in the case of sulfur because there would be no necessity for allocating the proper portion of income between the mining operation and refining, smelting, transporting, and so forth.

Treasury regulations were promulgated to define gross income from the property as used with respect to coal, metal mines, and sulfur. Regulations 77 promulgated under the Revenue Act of 1932, article 221(g), closely parallels the present day statutory provisions and regulations. These regulations said plainly that "gross income from the property" meant the selling price of the crude mineral product or, if the crude product were not sold as such but was processed, the field price before the application of any processes to which the crude mineral product may have been subjected (with the exception of certain specified processes discussed below) and before transportation from the place where the last of the specified processes was supplied. The processes enumerated, which were allowed to be applied to increase the value of the capital which was allowed tax-free recoupment, were clearly of the type which were regarded as processes which resulted in a product of a mine (i.e., mineral concentrates) as distinguished from a manufactured or refined product. Thus, coal could be cleaned, broken, sized and loaded at the mine for shipment; sulfur could be pumped, cooled, broken and loaded at the mine for shipment; and ores customarily sold in the form of a crude mineral product could be sorted, concentrated and loaded at the mine for shipment. Processes which resulted in a refined product, as compared to those which

still left the mineral in a crude state, were not allowed in arriving at a value of the capital which was to be allowed tax-free recoupment.

In the Revenue Act of 1943, Congress incorporated for the first time into the Internal Revenue Code the ordinary treatment processes which were to be included in the concept of mining and the income from which would be within the definition of gross income from the property (sec. 124(c), Rev. Act of 1943). In explaining this amendment, which originated as a Senate amendment, the Senate Finance Committee stated (S. Rept. No. 627, 78th Cong., 1st sess., pp. 23–24; 1944 cum. bull. 973, 992):

"The purpose of the provision is to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product should be considered as a part of the mining operation, and to give reasonable specification of what are to be considered such processes for various kinds or classes of mines.

"The law has never contained such a definition, and its absence has given rise to numerous disputes. The definition here prescribed expresses the congressional intent of these provisions as first included in the law, and *is in accord with the original regulations and the Bureau practices and procedures thereunder.* It is, therefore, made retroactive to the date of such original provisions." [Emphasis supplied.]

There is no concrete evidence that Congress intended going beyond the natural mineral product, or processes which would leave the crude mineral in such a state. On the contrary, it is clear that the definition of "gross income from mining" was intended as a codification of the Department's practice of allocating the income of integrated operators between mining and nonmining processes, and an endorsement of the procedures which the Department followed in making such allocations.

There is ample corroboration that such was the intent of Congress in 1943. During debate on the Revenue Act of 1942, Senator Johnson of Colorado (who proposed the definition in 1943 by way of an amendment) and Senator Thomas of Idaho discussed this facet of percentage depletion at length (88 Congressional Record, pt. 6, p. 8033). The latter recalled that when the amendments for percentage depletion were under consideration in 1932, it was the "understanding that the ordinary treatment processes which a mine operator would normally apply in order to obtain a suitable product should be considered as a part of the mining operation." Senator Johnson stated that the point had been discussed in the Senate Finance Committee with Mr. Paul of the Treasury Department, who urged that the matter be left to regulations rather than be covered by the law. Senator Johnson agreed, and stated in this exchange with Senator Thomas: "The Congress has not intended in the pending measure to make any change in its concept of mining income from that expressed in the 1932 and 1934 acts, nor to establish by implication or otherwise any approval of Treasury regulation or Revenue Bureau practice which departs from the original acts or the general Revenue practice prior to 1940."

Similiarly, Donald H. McLaughlin, testifying on behalf of the tax committee of the American Mining Congress, urged adoption of Senator Johnson's amendment during the Senate hearings on the Revenue Act of 1943, pages 527–529. He said: "The proposed amendment simply incorporates in the law the practices established by the Bureau under the 1932 regulations." Subsequently, a Senate report published in 1950 indicated as follows: "The code section here involved was added in the 1943 Revenue Act so that the law would clearly have the same meaning as intended by the depletion provisions in the 1932 act and contemporaneous Treasury regulations interpretative thereof." (S. Rept. No. 2375, 81st Cong., 2d sess., p. 53.)

In the year 1949 it was proposed in the Senate to extend the percentage depletion provisions to perlite and diatomaceous earth since they were competitive with ball and sagger clay, feldspar, mica, and pyrophllite. However, the percentage depletion provisions would apply to perlite and diatomaceous earth in the dried crude mineral form, before grinding or any other preparation for any particular market. (See S. Rept. No. 831, 81st Cong., 1st sess., pp. 9 and 10.) This report stated:

"It is not proposed to allow percentage depletion with respect to the value added as the result of grinding or other special preparation because many of the extractors do not themselves carry on this process, but rather sell these minerals in crude form and let others carry on any processing required. Thus to allow percentage depletion with respect to this added value would discriminate against

those selling these minerals in crude form, since percentage depletion is not allowable to processors."

Extensive hearings were held in connection with the revenue revision of 1950. (Hearings before the Committee on Ways and Means, 81st Cong., 2d sess.) On page 382, Mr. Kenneth B. Ray, representing the phosphate rock industry testified that "Following the addition of phosphates to the statute this company has expended over $10 million in an electric furnace project to utilize the Idaho phosphate deposits. The economics of this development are based on percentage depletion for the basic raw material, phosphate rock."

On page 387, Mr. Fred O. Davis, representing the American potash industry testified that percentage depletion does not go on the delivery price of potash but rather it is free on board at the mine. This, of course, was the crude mineral product beneficiated (concentrated) as provided in the law and regulations at that time.

In connection with the statement filed by Mr. E. A. Garber representing the majority of the producers of refractory or fire material, there appears on page 456 the following exhibit:

EXHIBIT II

Estimate of depletion allowance to manufacturers of clay and silica refractories based on percentage depletion of 15 percent

	Year 1947	Year 1948
Number of establishments (approximately)	240	240
Manufactured value of refractory clay and silica products	$137,000,000	$165,000,000
Raw materials used (refractory clay and quartzite):		
Tonnage (net)	5,400,000	5,200,000
Value	$29,400,000	$35,400,000
Estimated depletion allowance:		
(*a*) Basis:		
15 percent of value	$4,410,000	$5,310,000
Federal tax (38 percent)	$1,675,800	$2,017,800
(*b*) Basis:		
One-half of net income	$3,025,000	$3,328,000
Federal tax (38 percent)	$1,149,500	$1,262,600

NOTE.—(*b*) basis would apply, being less than (*a*) basis.

Thus, if it had been intended that the Congress should allow percentage depletion on the manufactured value of the finished products (as many of the same taxpayers listed in Mr. Garber's statement on pp. 455 and 456 have been permitted to do by various courts) line (*a*) of the exhibit should have been restated approximately as follows:

	1947	1948
(*a*) Basis: 15 percent of manufactured value	$20,550,000	$24,750,000

In the later hearings held before the Senate (hearings before the Committee on Finance, 81st Cong., 2d sess.), Mr. M. D. Harbaugh representing most of the Lake Superior iron-ore companies objected to the provisions included in the bill as passed by the House (H.R. 8920) on June 29, 1950, which would have eliminated transportation beyond the property. In explaining this feature of the House bill Mr. Colin Stam, chief of staff, Joint Committee on Internal Revenue Taxation, on page 302, stated "So I think the way the amendment (sec. 204(c) of H.R. 8920), was worded it was intended to put a limitation on the whole allowances but it started from the idea of sand and gravel and some of those minerals that they did not want to give a bigger allowance to than the value at the time it was taken out."

Further hearings were held before the Senate on the Revenue Act of 1951 (hearings before the Committee on Finance, 82d Cong., 1st sess.), and percentage depletion was again discussed. On page 911, thereof, Mr. Lloyd P. Webre, president, United Salt Corp. and vice president, Texas Brine Corp. read the following:

"Upon the basis of statistics released by the Bureau of Mines in its 1949 Minerals Yearbook, the total value of naked salt produced in 1949 amounted to

approximately $54 million. Carried further, this figure may be translated into effect upon Federal income and excess profits taxes as follows:

Value of salt	$54, 000, 000
Cost of mining, treatment, etc	27, 000, 000
Gross income from property	27, 000, 000
Percentage depletion, 15 percent	4, 050, 000

"If it is assumed that the selling and general expenses, interest, and so forth, are 80 percent of the gross income from the property, and that the depletion allowance is limited to 50 percent of the net income from the property, the deduction would be as follows:

Gross income from property	$27, 000, 000
Selling and general expenses, etc	21, 600, 000
Net income from property	5, 400, 000
Limitation at 50 percent	2, 700, 000"

Here again, if the taxpayers in the salt industry had intended that Congress should allow percentage depletion to be based upon the value of the finished product, without regard to the nature of the processes, they would have computed the depletion on the value of the salt ($54 million) rather than on their computation of gross income from the property ($27 million).

Based on the foregoing, it is clear that the legislative history of the percentage depletion allowances establishes that percentage depletion is not intended to be applied to the value of manufactured products but was to be applied to the value of the crude mineral product including those ordinary treatment processes which had been considered a part of the mining process under long-established administrative practice.

Mr. LINDSAY. Let me say also, Mr. Ikard, that I do think that we ought to take a look at what we intend to apply percentage depletion rates to, iron ore or an automobile, which would be the ultimate product, and I think we ought to consider trying to make it as uniform as possible.

Mr. IKARD. I would agree with that, but also, it seems to me that if these purposes which you and I agree on are to be achieved at all, they have to have really some practical application. If you take a rock in a field and attempt to apply the depletion rate of 10 percent to it, it does not mean anything.

The point I am making is that it at least appears to me that Congress must have intended, if this whole section was to have any meaning at all when they established these rates; that they were taking into consideration certain processes that were necessary to make a given product marketable. The whole philosophy of this section is based on this theory of having a market value and that when you lift that out, so to speak, to repeat, we are actually changing that philosophy.

To come back to what Mr. Baker and Mr. Curtis raised, I think probably we ought to look at the rates if we are going to change this whole basic outlook of this section.

I was just wondering, too, on this cutoff; for instance, in the area of clay products, how mechanically would you determine the factor, say, of common brick clay where there is no market for it?

Mr. LINDSAY. It would be based on an allocation.

Mr. IKARD. It would be just an arbitrary allocation or an allocation that was made of X amount of what? The finished product? Is that what you look at? Do you take the finished brick and work backward?

Mr. LINDSAY. I think you start with the finished brick and work backward.

Mr. IKARD. And then you take some place back and say, this is the cutoff point?

Mr. LINDSAY. That is correct.

Mr. IKARD. Are you not necessarily continuing the marketability idea when you take the finished brick, because I take it that whatever it sells for on the market, that has to be the price that you take and go back with.

Mr. LINDSAY. In a sense, yes, because the percentage depletion is applied to the gross income from the property.

Mr. IKARD. That is right.

You are not suggesting that the Treasury could have regulations that it would apply across the country to all these different operations that would be certain, are you?

Would this not lead to an almost impossible administrative situation if you have to make this determination all around the country?

Mr. LINDSAY. I think it is a problem that we can handle.

Mr. IKARD. And there are many different types and kinds of clays and some that have a market value, as I understand it, and some that do not; is that correct?

Mr. LINDSAY. Yes.

Mr. IKARD. With respect to those that do have a market value, would you take that, or would you take some figure beyond that and between the finished product?

Mr. LINDSAY. Where clay has a market value and the cutoff point is uniform and goes beyond the raw clay, we would take something beyond the market value of the raw clay.

Mr. IKARD. Then you could conceivably have a situation where inequity would develop simply because somebody might be able to sell his clay for a given price, while another operator would not have that market for his clay and the result would be that the man without a market would be getting a higher effective rate than the man who did have a low market value.

Mr. LINDSAY. That is the situation we are really trying to correct. That is a situation that the trend of the court decisions is leading us to now.

Mr. IKARD. I question whether you are not just bringing about a situation that would magnify it.

Mr. LINDSAY. We hope we are trying to bring about a situation that would minimize it.

Mr. IKARD. You would agree, I am sure, that there are areas where clay might have some market locally and that just a short distance away there might be more clay for which there was no market.

Mr. LINDSAY. That is correct.

Mr. IKARD. I think you would further agree that in that type of situation, that to follow the rules that you have just suggested here, you, in all probability, would come up with a situation where two competitors would be taking a different depletion rate.

Mr. LINDSAY. That is exactly where we are under the trend of the court decisions.

Mr. IKARD. I understand. I am talking about the remedy.

Mr. LINDSAY. Our proposed remedy would treat them alike.

Mr. IKARD. How would you treat them? That is the question I asked a moment ago. If you have this clay that they market, as I

understood you a minute ago, you said you would take the market value there.

Mr. LINDSAY. If the cutoff point went beyond that and they were making, say, finished brick, in both instances you would start with the finished brick and then work back proportionately to allocate that part of the gross income allocable to the clay when it reaches a certain point.

Mr. IKARD. However, as a practical matter, as I understand it, and I do not want to belabor the point, there are areas where there can be an established market price for a given kind of clay. I assume that to be correct.

There are many areas where there is no market value for the raw clay. My question is assuming two companies within a single geographical area serving the same, even though they may be apart a hundred miles or so, and one of them owned clay on which there was an established market value. I assume from what you said that you would deplete on that market value.

Mr. LINDSAY. That is what we would do now without this legislation.

Mr. IKARD. I misunderstood you then. With the legislation you would not do that? You would disregard the market value of the clay?

Mr. LINDSAY. Let's assume that both of these taxpayers are making brick and selling brick. In both instances we would work back from the gross income attributable to the sale of the brick to reach that portion of the gross income attributable to clay when it reaches a certain stage in the development of the brick, in the manufacturing of the brick, before the heating. Under existing law, if one taxpayer can sell and has a market for his clay, he would base his percentage depletion on that; whereas the other taxpayer who has no market for his clay would base his percentage depletion on the finished brick, and there you have a very real and sharp discrimination.

Mr. IKARD. That is right.

As I understand it, you would not then in any case be concerned with what the market value of the clay was. You would apply your formula, whatever it might be, and, in any case, you actually would be taking depletion on an artificial figure that the Treasury would create. It would be created through some formula that was devised.

Mr. LINDSAY. I would think in most instances the taxpayers following the statute would be making their own allocations, and assuming they were reasonable, they would be accepted.

There will of course be some controversies in that area.

Mr. IKARD. You mentioned, on page 18 in your statement, this LaGloria case, and you stated there in the first full paragraph, in substance, that the implications of the case were that the integrated companies in the oil and gas industry might claim that they would be entitled to base their depletion allowances upon the value of refined products.

Let me hasten to say I do not disagree particularly with what you suggested in your legislative recommendations. However, I do disagree with this statement, because I do not think it would necessarily follow, or even remotely follow, from the LaGloria case.

As I understand the facts in that case, and you correct me if I am wrong, that was a case where there was no market for heavy hydro-

carbons of natural gas; there was a cycling process where they were not selling the gas itself, but actually putting it back in the ground. During the cycling they extracted these heavier materials for which there was a market, and the court in effect held that they were actually producing these heavier materials. This was not a refining process.

That is merely to control the temperature, as I understand it. It allows these heavier substances to drop down. Without getting into the technical side of it, they are separated and the gas goes back into the ground. So we are not really talking about the manufacture of gasoline, or motor oil, or anything like that, and I think you would agree that, at least as far as I know, no one in the oil industry has suggested even remotely that anybody take depletion on refined products.

Have you heard any such suggestion? I mean, from the industry.

Mr. LINDSAY. No, I have heard no such suggestion.

Mr. IKARD. While I say I do not quarrel with your recommendation particularly, I think, with all due respect, that someone's imagination ran a little rampant on page 17 of the statement, with which I would not agree. I wanted to make that very clear.

I believe that is all, right now, Mr. Chairman. I may have some questions later on.

Mr. SIMPSON. With respect to this pricing plan, do I understand that you start with the finished property and work back to where the cutoff would appear?

Mr. LINDSAY. Generally speaking, yes.

Mr. SIMPSON. With respect to the finished brick, to the finished brick in the hands of the customer, or where?

Mr. LINDSAY. If the taxpayer mined the clay and manufactured brick and didn't sell the clay to a third party, we would have to start from the price he received on the finished brick in order to determine the gross income from the property.

Mr. SIMPSON. And in the case of the man who sells his clay at a point somewhere between the finished brick and the clay out of which the brick is made, you would accept his selling price?

Mr. LINDSAY. Yes; the selling price would be it.

Mr. SIMPSON. Do you do that today?

Mr. LINDSAY. Yes.

Mr. SIMPSON. And you do not intend to change that in any respect?

Mr. LINDSAY. I don't believe so.

Mr. SIMPSON. Is that the marketable mineral product that we explain in the law under mining? Is that not to be changed?

Mr. LINDSAY. We do change the language of the statute. We eliminate the term "commercially marketable product or products."

Mr. SIMPSON. Why do you eliminate it if you do not change the intent?

Mr. LINDSAY. We leave the term "gross income of the property" intact.

Mr. SIMPSON. Why do you not leave it in if it does not change anything?

Mr. LINDSAY. Because that language led to our difficulty and to the court decisions.

Mr. SIMPSON. What do you substitute for that?

Mr. LINDSAY. We substitute a specification of the treatment processes which are to be considered mining and a specification of the treatment processes which are to be considered nonmining or manufacturing.

Mr. SIMPSON. But in the case of clay, I understand you to say that if the manufacturer has a point at which the commercial marketable product is available and the price is established, you accept that?

Mr. LINDSAY. We cut back on the product in allocating the amount of the gross income from property to the so-called cutoff point, so that, even though you sell finished brick, the gross income from the property would be that part of the gross income attributable to the clay when it reaches a certain stage, rather than to the entire sales price attributable to the brick.

Mr. SIMPSON. I understand that.

Also, in addition to that, where the manufacturer has a commercially marketable product at the present time and has a price established, you said a moment ago you accepted that under existing law.

Mr. LINDSAY. If the producer was just selling clay——

Mr. SIMPSON. He is selling a commercially marketable mineral product and the price is known and established. You said a moment ago you would accept that under existing law.

Is that right or is that wrong?

Mr. GLASMANN. I think Mr. Lindsay's answer took into account the fact that if a man sold clay after he dug it out of the ground, that that would be an allowable process and, therefore, the selling price would be the thing we would allow.

Mr. SIMPSON. That was not my question at all.

Mr. GLASMANN. I believe that is what Mr. Lindsay said.

Mr. SIMPSON. The answer was: When you have a commercially marketable product with respect to clay that you accept that price, that point being somewhere prior to the creation of the brick.

Is that right, or am I wrong?

Mr. LINDSAY. If it does not go beyond the allowable process——

Mr. SIMPSON. Under existing law?

Mr. LINDSAY. Under the proposed statute.

Mr. SIMPSON. I want to know under existing law, now.

Mr. LINDSAY. Under existing law if there was an established market for the clay. I think also, there, the percentage depletion would be based on the sale price of the clay.

Mr. SIMPSON. That is the answer you made a bit ago.

Mr. LINDSAY. Yes.

Mr. SIMPSON. To restate it, it means, as I understand it, that if the mineral product is processed short of the actual making of the brick at a point where there is a commercially marketable product, you at the present time accept that as the point of cutoff and base depletion upon that. Is that right?

Mr. LINDSAY. My associates are telling me that it depends on whether or not it went beyond the allowable cutoff point.

Mr. SIMPSON. Under existing law?

Mr. LINDSAY. Yes.

Mr. SIMPSON. Is not the allowable cutoff point under existing law the commercially marketable product?

Mr. LINDSAY. First commercially marketable product.

Mr. SIMPSON. That is my question.

We have come to the first commercially marketable product and the price is established. My question is do you accept that as the point of depletion under existing law?

Mr. LINDSAY. My answer would be yes.

Mr. SIMPSON. Is that borne out by your practices?

Mr. LINDSAY. I know of cases in which there has been some dispute in that area as to whether the clay sold is representative of the clay not sold. I have in mind mortar clay. Mortar clay sells at a higher price than the clay used in the manufacture of the finished brick and if that established price for mortar clay is used as the assumed price for the clay consumed in the brick, we would not necessarily agree that it was the proper marketing price for the ordinary clay.

Mr. SIMPSON. If it is the same clay in fact, that in another step becomes a brick, and the price is established for that clay as the first commercially marketable mineral product, according to what you said a bit ago, that then would be the price on which depletion would be allowed under existing law.

Mr. LINDSAY. That problem is before us now.

Mr. SIMPSON. You are trying to change that and provide a cutoff point somewhere short of the commercial product?

Mr. LINDSAY. For the ordinary clay used in the brick, we would provide a cutoff point, at the point before the burning, and base the value of the gross income from the product on an allocation of the price received for the finished brick rather than basing it on some other clay that sold at a higher cost.

Mr. SIMPSON. Then in effect you want to remove the first commercially marketable point as being the point at which depletion would apply?

Mr. LINDSAY. Our proposed statute would do that.

Mr. SIMPSON. And Congress and the courts have upheld commercial marketable meaning just what it says.

In the first place, it can be sold in a common market, is that not right?

Have not the courts held that the law means what it says, the commercially marketable mineral product is the point at which depletion would apply as being the point at which the substance is first available to the customer?

Mr. LINDSAY. Yes, the courts have, and in most of those cases that we have acquiesced in it was stipulated in the record that there was no market for the raw clay. There is still in dispute before the courts what happens in the case where a taxpayer has a market, but goes on and manufactures a product beyond that market, to determine whether he is held to the first conceivable market or whether he may take his percentage depletion on his finished products.

Mr. SIMPSON. You mean where there is more produced than the market would absorb at a point and he goes on and makes the finished product out of it?

Mr. LINDSAY. Perhaps there is not more produced than the market would absorb and he still goes on and makes the finished product. I imagine you would have both kinds of cases.

Mr. SIMPSON. How would you apply this pricing method with respect to areas of the United States?

I understand that the final word would rest with the Treasury's representative as to whether or not company A, or company B would have more or less in depletion, varying with the costs in the particular area of the country. That would depend on the findings in the final analysis of your aids, would it not?

Mr. LINDSAY. We still have under consideration and are working in cooperation with the chief counsel's office and the Justice Department, analyzing decisions and attempting to determine whether we should base the regulations in this area on a local market or on a national market.

Mr. SIMPSON. You mean a regulation that will be written if and when this becomes law?

Mr. LINDSAY. No, the regulations under existing law trying to follow the court decisions.

Mr. SIMPSON. What was the practice before the court decisions?

Mr. LINDSAY. Before the court decisions we looked at the regular cutoff point that we assumed was the appropriate point, much along the lines of this bill.

Mr. SIMPSON. On page 16 the reference is made in the last paragraph to the fact that the problem has been giving you a great deal of concern. You go on to say there are instances under present law and administrative practice where mineral producers are allowed depletion on processes which would be considered manufacturing under the general rules of your draft bill.

Then you go on and suggest that in the case of cement you are going to allow those administrative practices to be continued and included even though they are not mining processes; is that right?

Is that what you are saying there?

Mr. LINDSAY. Even though they may not be considered mining processes, yes.

Mr. SIMPSON. Is the cement industry the only place where those factors exist?

Mr. LINDSAY. No. The existing statute provides that certain treatment processes that would have otherwise been considered as manufacturing processes, should be considered as mining processes, and we have not attempted to change the statute in that regard.

Mr. SIMPSON. And you call that an administrative practice?

Mr. LINDSAY. The last one I referred to is statutory.

Mr. SIMPSON. Then wherever there is an administrative practice in existence today, you will not change that?

Mr. LINDSAY. We are trying to follow established administrative practice.

Mr. SIMPSON. You say here you will not change it with respect to cement.

Mr. LINDSAY. That is right.

Mr. SIMPSON. Where else will you not change administrative practice?

Where else would you follow it other than in the cement?

Mr. LINDSAY. We tried to follow it all the way through.

Mr. SIMPSON. You have administrative practices in each specific item perhaps?

Mr. LINDSAY. Yes.

Mr. SIMPSON. With respect to cement, you are going to continue these practices no matter what this law says, is that right?

Mr. LINDSAY. There was a question raised as to whether or not the second bill we introduced as compared with the bill submitted last year cut back on cement further than administrative practice. It could be construed in that way. It was not clear and we did not intend to cut back on cement further than has been allowed by administrative practice.

Mr. SIMPSON. In the cement industry, or in every industry.

Mr. LINDSAY. In every industry. The question was raised specifically in terms of cement because the proposed statute could be construed as being stricter than administrative practice.

Mr. SIMPSON. Does not that last statement you made apply to these other areas like the clay and so on, or other minerals?

Mr. LINDSAY. We thought that the bill was clear with respect to the other minerals and no questions have been raised with us.

Mr. SIMPSON. I have to ask it this way: Is it your intention to change the administrative practices in any of these areas?

Mr. LINDSAY. No.

Mr. SIMPSON. What are the administrative practices that would be uncertain to the members of the committee that you have in mind with respect to cement and all these other industries? Can you list every one of them for us?

Mr. LINDSAY. Yes, we can list every one of them.

Mr. SIMPSON. Are they generally liberalizing administrative practices from the standpoint of the industry?

Mr. LINDSAY. No, I would not say that.

Mr. SIMPSON. Are they with respect to cement?

Mr. LINDSAY. No. By administrative practice, we are merely referring to what had been understood to be the proper interpretation of the cutoff point by the Internal Revenue Service, in many cases by taxpayers, prior to the court cases.

Mr. SIMPSON. Does that not mean that you are not going to change the cement industry in the slightest?

I think it does.

Mr. LINDSAY. We change them from the situation that they find themselves in under the Dragon Cement Co. case, which would give them percentage depletion based on cement.

Mr. SIMPSON. What has been the administrative practice with respect to bags of cement?

Mr. LINDSAY. I think that we allow all the processes up to the point that the mineral goes into the kiln. I am looking up cement now.

Under our administrative practice with respect to cement, the ordinary treatment processes considered as mining include quarrying, crushing and grinding, and screening and filtering of the slurry.

Mr. SIMPSON. You do not intend to change that?

Mr. LINDSAY. No.

Mr. SIMPSON. So that with respect to cement, whatever has been the practice, whether law or administrative practice, to the moment will not be changed by this new proposed law?

Mr. LINDSAY. Administrative practice that we have followed for years would not be changed. The effect of some court decisions would be changed.

Mr. GLASMANN. The processes we have cut back on cement would be the heating in the kiln and the grinding of the clinker and the bagging. We would not allow those under our bill.

Mr. MASON. Will you yield?

Mr. SIMPSON. Yes.

Mr. MASON. Under the present dry process in cement we quarry the rock, we break the great big chunks down to small chunks, and we mix certain other things in it. We then grind it to powder. Then we put that powder in the kiln and burn it into clinkers.

Mr. LINDSAY. That is right.

Mr. MASON. That clinker then is reground into cement and put in bags and is ready for shipment.

Under present law you have to pay the depletion on the cement in bags as the first commercial product. Under the law that you want us to adopt, you would cut off before you burn it to a clinker, would you not?

Mr. LINDSAY. That is right.

Mr. MASON. Therefore, the process of burning, the process of grinding the clinker, and putting it into bags would be cut off from the present situation, would it not?

Mr. GLASMANN. That is right.

Mr. SIMPSON. Thank you very much, Mr. Mason.

What does that last part mean?

It is our hope, therefore, that if Congress should choose to continue the existing exceptions, it will not regard them as a precedent.

What exceptions are you talking about there?

Mr. LINDSAY. There are certain provisions such as fine pulverization of talc which Congress chose to include in the statute which we would have otherwise considered to be a manufacturing process.

Mr. SIMPSON. However, you are willing to accept that in the case of cement, is that right?

Mr. LINDSAY. That is in a sense an exception too before it gets into the kiln. Where there is further grinding after that, we would disallow it.

Mr. SIMPSON. You do not indicate that.

To my reading, it indicates here that what you want to do is to permit everything they do today.

Mr. LINDSAY. We want to hold the line. Let's put it that way.

Mr. SIMPSON. Hold the line?

Mr. LINDSAY. Yes.

Mr. SIMPSON. Back on the pricing question. You are going to start with the end product and go back to the mineral.

With respect to gasoline, will you start in the new legislation there with gasoline and work back to petroleum, or how do you plan to handle that?

Mr. LINDSAY. Your question was on whether or not we would start with the price of gasoline and work back?

Mr. SIMPSON. To petroleum, yes, to find the base for the application of depletion rates.

Mr. LINDSAY. I don't believe we do it that way.

Mr. SIMPSON. Would you treat that differently than you treat other minerals then?

Mr. LINDSAY. I think it is a different problem there because in most instances there is a well-established market for oil and for gas.

Mr. SIMPSON. Yes, but there will be a lot of people who will say, why would you start with the finished brick and work backward and not start with gasoline and work backward.

Mr. LINDSAY. You have to start with finished brick in those cases where there is no market for the clay. In the case of oil and gas, when there is an established market, we do not have to worry about that problem.

Mr. GLASMANN. You could start at the end and work back and wind up with the same result. You don't have to in oil and gas, however.

Mr. SIMPSON. Where we do establish a price for the product under existing law short of the finished product, at that point under existing law we are permitted to apply the depletion rates?

Mr. LINDSAY. Yes.

Mr. SIMPSON. Under the new bill we will not be able to do that because there we will start with the finished product, and the Treasury itself will construct or reconstruct the cost to the manufacturer at that point and apply the rates there?

Mr. LINDSAY. It would have to vary according to whether or not the taxpayer sold his crude products. If he never sold his crude products, one would have to work back from the finished product.

Mr. SIMPSON. Are you talking about the taxpayer, or the industry?

Mr. LINDSAY. I am talking now about the individual taxpayer.

Mr. SIMPSON. Each one is considered on an individual basis under the proposed new bill?

Mr. LINDSAY. On a uniform basis.

Mr. SIMPSON. Are they so considered today?

Mr. LINDSAY. Under our administrative practice, we attempt to apply a uniform rule. Under the court decision we are forced into situations where there will be different rules applied according to whether or not there is a local market for the crude product.

Mr. SIMPSON. Thank you very much.

Are there any further questions?

Mr. IKARD. I have one question, if I may.

The CHAIRMAN. Go ahead, Mr. Ikard.

Mr. IKARD. Mr. Lindsay, I would like to go back again to this question that I asked you a moment ago and Mr. Simpson got into.

On this cutoff point, as I understand at the moment, the market value of the raw product would not in any event be taken into consideration at the point that depletion would be applied; is that right?

Mr. LINDSAY. I am not sure what you mean.

If it is sold, it would have to be taken into consideration.

Mr. IKARD. To go back to the example that I gave a moment ago, as I understand it, with reference to fire clay, there are some areas in which it has had market value of something around $15 or $18, other places where it is much cheaper, and maybe others where there is no market value. This is back to the same question we were pursuing a moment ago and I have gotten confused on it.

Where you were in an area where there was an established market value, would you take that into consideration or would you apply this formula which you have devised to work back from the finished product?

Mr. LINDSAY. I think if it is a representative price we would.

Are you talking about how we do it now?

Mr. IKARD. No. I think I am remotely familiar with that. I am talking about how you proposed to do it under the legislation that has been suggested here.

Mr. LINDSAY. If the taxpayer who has a market value for his fire clay, refractory clay, sells it, that necessarily will determine, I would think, the gross income from that property.

Mr. IKARD. That is his price that he must deplete at that point?

Mr. LINDSAY. That is right.

Suppose he does not sell it, but produces furnace linings or face brick where there is fire clay. We would first look at the gross income from the finished property and then allocate back to find that portion of the gross income attributable to the clay up to the point it reaches the cutoff point, which would be including drying, crushing, and loading for shipment, and so forth, but it would not include burning in the kiln or cooling.

Mr. IKARD. Then to repeat the question I asked, are you really doing anything actually as a practical matter about this situation that now exists where you have these inequities with competitors operating under different depletion rates?

Mr. LINDSAY. Yes, I think we are doing something about it because, under existing law, under the trend of the court decisions, if one of the taxpayers mined refractory clay and produced say, furnace linings and in his particular area there was no market for the raw clay, he would take his percentage depletion based on the finished product, the furnace linings, whereas the other taxpayer some distance away who had a market for the crude clay would be taking, and having to take, a percentage depletion based on a smaller amount.

Mr. IKARD. That is the point.

I think we would remove that discrimination. Would you put them both on the market value, or would you put them both on this formula that you have?

Mr. LINDSAY. We put them on the formula, and of course if there is any clay sold at the point before it reaches the cutoff point, that automatically determines the price and the gross income from the product.

We solve the discrimination by cutting back the other taxpayer, even though he doesn't sell the raw crude clay, but merely produces furnace linings, so that he will not get more percentage depletion, but is cut back to the point which more or less should be the same as that taxpayer who sold his clay.

Mr. IKARD. We seem to be going in circles.

Mr. GLASMANN. Let me take a crack at it.

Where you have two taxpayers who are producing the same type of product, their depletion would be based upon the same base. If one of them actually does not produce the product at all, but sells his clay in the crude state, he will have as his depletion base the gross income from the sale of the clay in the crude state.

Mr. IKARD. I understand that. That is not the question, though.

Mr. GLASMANN. So that we are trying to keep uniformity of treatment among taxpayers who have the same product.

Mr. IKARD. Assume two taxpayers manufacture and sell the finished product and one of them, either himself or somebody else in the area, has a clear market value established for this particular fire clay; no question about it. You can go out and just find out what it is worth. The other man operates in an area where there is no market value and this, as I understand, is a common situation in the industry.

That is the question that I have in my mind; not where one sells it and the other one processes it.

Mr. GLASMANN. We would give both of those people the same treatment by starting at the end price.

Mr. IKARD. Would you give them the sale price, or the formula?

Mr. GLASMANN. It would be the selling price of the brick worked backward under the proportionate profit allocation formula.

Mr. IKARD. In other words, even though a man may have sold some clay to somebody else where there may be an established market, you would not use that market value in calculating depletion as far as that man was concerned?

Mr. GLASMANN. Not to the extent that the portion of his products are bricks. We would use the actual selling price of the bricks for that proportion of his total brick or clay production and sale.

We might very well use a different base for that portion of the clay that goes into a different area or is sold as a crude clay.

Mr. IKARD. My point is simply this: that the express purpose of this proposal is to bring about uniformity of treatment. Is that not correct?

Mr. GLASMANN. Yes.

Mr. IKARD. Or let's say that is one of the reasons, and I frankly still am a little lost. It still looks to me as if, rather than bringing about uniformity of treatment, conceivably you could be developing more confusion and certainly an area in which there no doubt would be a great deal of litigation over this cutoff point.

Mr. MASON. May I try to clarify your question?

Mr. IKARD. Yes, sir. I would be delighted.

Mr. MASON. We have two producers of clay, A and B. A sells his raw product for the market price. You, of course, propose to base the depletion allowance on that market price for the raw product.

Mr. GLASMANN. That is right.

Mr. MASON. The other chap produces clay. There is no sale for the raw product. He changes his raw product into brick. You do not allow him the sale price of brick. You go back a certain way to get your formula and then you base your depletion allowance on that formula, not on the price of the raw product that the other fellow sold, not on the brick price, but somewhere in between that. No one knows where it is.

Is that not what you were trying to arrive at?

Mr. IKARD. That is what I have been striving for, Mr. Mason.

Mr. Lindsay, to get away from brick, maybe I can take something else.

Let's take dimension stone, granite, which I believe appears in paragraph (6) of the section 613.

As I understand it, it really has no real value until such time as it is cut to size, and color and other things come in. In that area you would do the same thing?

You would go back? You would take the selling price of this dimension stone and go back to some point and determine where the cutoff depletion would be?

Mr. LINDSAY. Yes. We would go back and permit quarrying and loading, but not sawing, or shaping, or polishing, so that if the taxpayer shaped the stone and polished it and then sold it, we would have

to find a proportionate part of the income allocable to the stone attributable to the mere quarrying and loading for shipment.

Mr. IKARD. I think you have your work cut out for you.

That is all, Mr. Chairman.

The CHAIRMAN. Mr. Utt will inquire, Mr. Lindsay.

Mr. UTT. Mr. Lindsay, I think we are generally agreed that the basic theory is that the replacing of a wasting asset and the depletion cutoff are absolutely tied together in order to determine what a man is going to get to replace his wasting asset, and you cannot determine one without the other any more than you can set a tax rate and continue to know the percentage of the assessment as compared with the actual value or the market value of the land to be assessed. We are going to have to work together.

I want to ask a question or two about a comment from you on the inequity that might exist between the lessor and the lessee or an actual owner of a deposit.

For example, say that I own a limestone deposit and I sell that limestone either in place for so much a ton or deliver it at the railhead or at the cement factory. I am allowed a depletion on that sale.

Now, would the cement company be allowed a further depletion allowance on the manufacturing and processing of that limestone?

Mr. LINDSAY. No. That raises the question of economic interest.

You have to have an economic interest in the minerals in place before you are entitled to percentage depletion. This bill doesn't get into that question. It leaves it where it is.

Mr. UTT. It is my asset that is being depleted and even though I sell it to him on a percentage basis, a lease basis, it is still my asset that is being depleted, and then as it is manufactured and the value increases almost 10 times, according to your statement or your figures here, he is allowed 10 times as much depletion as I am who is the owner of the mineral in place.

Is there any allowance or protection for that situation?

Mr. LINDSAY. That gets back to the cutoff point.

If the cutoff point is proper, the manufacturer wouldn't be able to increase his percentage depletion base.

Mr. UTT. If I have a market for my lime in place or deliver it at the railhead, is another company who owns the deposit and owns the manufacturing process going to have to go back to the cutoff that his neighbor has where he sells his lime in place or at the railhead?

Mr. LINDSAY. Substantially, yes.

Mr. UTT. In other words, your administrative practices, as brought out by Mr. Simpson, might be varied. If you could determine that there was a lower market price for the limestone at the railhead, the cement company might have to go back to that cutoff point?

Is that possible?

Mr. LINDSAY. If I understand your question correctly, I think it is possible.

Mr. UTT. Which could throw the whole depletion schedule out of kilter?

Mr. LINDSAY. Let me say this generally about cutting back, taking a proportionate amount of the profit from the finished product.

Where there is a market for the raw mineral at the stage at which percentage depletion is going to be allowed, that probably is a fair

measure of the proportionate profit attributable to that raw mineral, proportionate profit from the sale of the finished product.

Now, you could work back to that on a formula and it may be that you come out with the same result as you would have if you looked at the quoted price for that raw mineral. Ideally the two systems would come out with the same result.

I do not think they always will. There will be minor differences, but the differences will be less than we have now with some taxpayers being permitted to base their percentage depletion on the finished product without any cutback at all.

Mr. UTT. Do you not face the administrative problem of practically every mineral having a market value in its raw stage? In other words, I can sell tungsten ore, or I can sell copper ore, or practically any kind of ore that I produce to an ore buyer for a certain figure, based on an assay. Then the other miners are all going to have to go back to that point where I had a market for my ore?

Mr. GLASMANN. Under existing law, that is what we would try to do, but under the draft we allow certain treatment processes to the man who mines and separates his own waste, so that the man who carried it farther would get more under this proposed draft.

Mr. UTT. One other question that follows up the remarks of Mr. Simpson regarding the existing regulations and the administrative practices.

You have indicated in your statement that this bill is supposed to support or back up your present administrative practices and your rules and regulations.

Is there anything in the bill that would change present rules and regulations and administrative practices?

Mr. LINDSAY. Nothing substantial.

I will say that there is an attempt to make some changes in the statute to remove a discrimination between taxpayers who have crude which is not salable.

There are shipping processes allowed for certain taxpayers in the code and not for others, and we would permit all taxpayers to include shipping cost, loading for shipment, and that of course necessarily would mean a change in administrative practice.

That is liberalizing it, however. That is a liberalizing change.

Mr. UTT. There are several processes that are neither excluded in section (4) (A) and several that are not included in section (3) (C). You have a catchall in there saying that other process is necessary to make your product marketable, so we still have a gray area to try to determine anything, but I have this specific question: Would there be anything in this bill that would prohibit the present practice of allowing decarbonization on soda ash?

Mr. LINDSAY. That is an established process now?

Mr. UTT. It is an established process, but is there anything in the bill that would indicate a change in that established practice?

Mr. LINDSAY. Not intended.

Mr. UTT. That is all.

The CHAIRMAN. Mr. Metcalf will inquire.

Mr. METCALF. Thank you, Mr. Chairman.

I want to know a little bit more about processes, especially about iron ore. I think the taconite process would serve as an example for my question.

As I understand it, taconite is pulverized in very fine form and then there is magnetic separation and pelletizing. My question is whether all of those processes would be included so that they could take advantage of the depletion allowance down to the pelletizing process.

Mr. LINDSAY. The intention is to include all those processes, pelletizing, if needed, for shipping.

Mr. METCALF. In this low-grade iron ore process, in order to ship it to the mills it has to be pelletized?

Mr. LINDSAY. Yes.

Mr. METCALF. This section (4) (A) at the bottom of page 2 of the bill, which speaks of electric smelting, and refining, pulverization, and so forth, would not apply to a process such as I have described?

It would be under section (3) (C), higher up in the bill, as I understand it.

Mr. LINDSAY. That is correct. It is not intended to so apply, and if there is any doubt about it, we will try to clarify the statute.

Mr. METCALF. When there is a chemical change such as we have in the refining of copper or the smelting of our copper ores, as I understand it, this section 4(A) is to apply?

Mr. LINDSAY. And it would be disallowed.

Mr. METCALF. And it would not be a mining process?

Mr. LINDSAY. It would not be a mining process.

Mr. METCALF. Thank you, Mr. Chairman.

The CHAIRMAN. It is now time for the committee to recess for lunch.

Will it be convenient for you to be back at 2 o'clock?

Mr. LINDSAY. Yes; it would.

The CHAIRMAN. Some other members of the committee have some questions.

The committee will adjourn until 2 o'clock.

(Thereupon, at 12:35 p.m., the committee recessed, to reconvene at 2 p.m., same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will please come to order.

Mr. Lindsay, in view of the questions this morning, did you have something further you wanted to say before further questioning?

STATEMENT OF DAVID A. LINDSAY, ASSISTANT TO THE SECRETARY, TREASURY DEPARTMENT, ACCOMPANIED BY JAY W. GLASSMAN, ASSISTANT GENERAL COUNSEL, TREASURY DEPARTMENT; EDWARD C. RUSTIGAN, ASSISTANT HEAD, LEGAL ADVISORY STAFF, TREASURY DEPARTMENT; PAUL F. SCHMID, ASSISTANT HEAD, LEGISLATION AND REGULATIONS DIVISION, INTERNAL REVENUE SERVICE; AND RUSSELL C. McGINNIS, ASSISTANT CHIEF, NATURAL RESOURCES SECTION, INTERNAL REVENUE SERVICE)—Resumed

Mr. LINDSAY. Yes, Mr. Chairman.

The questions indicated that there is some belief that we are proposing a marked change in the statute as Congress intended it to operate.

We propose merely the enactment of the total scheme as it existed under the regulations and the statute from the 1920's to at least 1955, the year of the Cherokee case decision.

In 1943, for the first time, the language of marketability was introduced in the statute. The Senate Finance Committee Report, Report No. 627, 1943, states with reference to that new language:

> The law has never contained such a definition, and its absence has given rise to numerous disputes. The definition here prescribed expresses the congressional intent of these provisions as first included in the law, and is in accord with the original regulations, and the bureau practices and procedures thereunder. It is therefore made retroactive to the date of such original provisions.

Before the Senate Finance Committee, Mr. Donald H. McLaughlin, on behalf of the American Mining Congress, said:

> The proposed amendment simply incorporates in the law the practices established by the bureau under the 1932 regulations.

Again in 1949, two minerals, diatomaceous earth and perlite, were added. And with respect to this addition, the Senate committee report states as follows:

> It is not proposed to allow percentage depletion with respect to the value added as the result of grinding or other special preparation, because many of the extractors do not themselves carry on this process but, rather, sell these minerals in crude form and let others carry on any process required. Thus to allow a percentage depletion with respect to this added value would discriminate against those selling these minerals in crude form, since percentage depletion is not allowed to processors.

Another problem that was discussed this morning has been with us all along, and that is a problem under the first marketability test, and will continue to be a problem under our proposed statute. It relates to the proportionate profits measure that Congressman Ikard was questioning me about. There is a notice of proposed rulemaking outstanding, proposed regulations, which provides flexibility in determining the measure of the proportionate profits.

If a taxpayer does not sell the crude mineral, but processes it beyond the mining stage, the regulations provide that the market price of the gross income product must be determined by the use of appropriate methods with the objective of determining as accurately as practicable the price at which such gross income product would be sold if such commercial sales existed.

Among such methods that may be appropriate, depending on the circumstances of each individual case, are the following:

1. Comparison with the prices at which crude mineral products or processed mineral products similar to the taxpayer's gross income product are sold commercially in the vicinity of the taxpayer's mine.

2. Comparison with the prices at which crude mineral products or processed mineral products identical or similar to the taxpayer's gross income product are sold commercially in other areas; or a computation based on the taxpayer's cost of producing the gross income product, plus the rate of profit per unit of product, per dollar of cost or per dollar of investment in mining.

Such rates of profit may be ascertained by comparison with profits of others or by looking just at the taxpayer or any other appropriate method.

Those are the remarks I wished to make, Mr. Chairman, in light of this morning's questioning.

The CHAIRMAN. Mr. Betts will inquire.

Mr. BETTS. I wanted to ask one question. I am not quite clear. Have you told us or given to us the precise method you use to determine the new cutoff point in the manufacture of end products?

Mr. LINDSAY. By statute we attempt to do that, yes.

Mr. BETTS. I didn't recall, in your prepared statement, that you gave us the formula, did you?

Mr. LINDSAY. We didn't name the cutoff points in the prepared statement for each mineral. We stated the principle on which we drafted the legislation, which is generally that those processes necessary to separate waste materials from the mineral would be allowed as a mining process, and those processes which would produce a chemical change would normally be treated as a manufacturing process.

With this exception: The existing statute names certain processes for certain minerals as being mining processes, even though they would, under our general formula, be treated as nonmining processes. We have continued on with those special exceptions in our draft legislation.

Mr. BETTS. When would you determine the cutoff date on this tile?

Mr. LINDSAY. Before burning.

Mr. BETTS. I just wanted to get the explanation as to why that point rather than any other point. To me that is the most important part of this.

Mr. LINDSAY. I would say the processes before that stage really are an attempt to separate waste materials in the clay and put it in shape so that it can be either shipped to somebody else or made into a tile product. I think the manufacturing starts with the burning.

Mr. BETTS. In other words, at that cutoff point the product has probably no value at all, is that correct?

Mr. LINDSAY. Less value.

I am just examining my chart on the brick and tile, and the processes allowed are crushing and granulating or secondary grinding. We stop at the pugmill. That is before the burning. So I was in error before. I would agree with you that if you stop at the earlier point there is less value than if you stopped with the finished product.

Mr. BETTS. That answers my question. I do not quite see the theory back of it.

Mr. LINDSAY. The theory back of it is the thought that percentage depletion is based on the mineral and on mining processes and not on manufacturing. There are many people engaged in manufacturing in this country that do not have percentage depletion.

Mr. BETTS. Of course, as far as the clay is concerned there is absolutely no value attributed to extraction.

Mr. LINDSAY. For some clay there is considerable value, because some clay is quite rare. Other clay is rather cheap and plentiful. If it is cheap and plentiful, perhaps the theory behind percentage depletion is not as appropriate as it would be with a rare mineral that was being exhausted.

If you extend it to the manufacturing processes, then we would be selecting a particular group in the country and giving them percentage depletion on manufacturing, not on mining.

Mr. BETTS. Of course, then, under the formula you have determined there, you are working to the detriment of part of the clay industry,

as I understand. For instance, that part of it which deals with clay that has no value at all if it comes out of the kiln. Is that right?

Mr. LINDSAY. We are trying to give them percentage depletions on the value of the mineral property, not on the manufactured product. Of course, if cost depletion is higher, they would take that.

The CHAIRMAN. Mr. Watts will inquire.

Mr. WATTS. Mr. Lindsay, the proposed legislation, as I understand it, attempts to define what is mining by setting out the particular processes that you can go through and still be within the classification of mining, and then certain processes that, if you go through, you go beyond mining, is that the general idea?

Mr. LINDSAY. That is correct. That is the general idea, Mr. Watts.

Mr. WATTS. Let us talk about clay. Visualize a market for clay, not making it for tile. Suppose that one of the things that you want to prohibit, one of the processes that you say shall not be considered as mining, was the fine pulverization or some type of pulverization necessary in order to properly eliminate from that clay foreign substances or to dry it out properly.

Do you contemplate that these definitions are so tight and are going to be so tight that the producer of that clay would not be permitted to step over into that field, provided that was necessary for him to be able to market that clay as a raw product?

Mr. LINDSAY. No, we do not contemplate that. We do not intend it.

Mr. WATTS. When you speak, then, of getting it in shape, on page 13 of your statement, it says to bring a mineral or ore into physical form or condition which is suitable for shipment and loading for shipment, of course I can visualize where something could be shipped or readied for shipment that certainly had not gone through sufficient processes to make it marketable.

Do you mean any shipment, or do you mean to get it in shape where it can be sold?

Mr. LINDSAY. I do not mean necessarily to put it in shape for sale.

Mr. WATTS. I do not mean manufacturing. I mean as clay.

Mr. LINDSAY. But as clay, just because it might have been shipped in cruder form, we do not mean to exclude the normal processes necessary to bring the clay in shape for proper shipment.

Mr. WATTS. Well, of course, clay is mined——

Mr. LINDSAY. It is a difficult problem of definition.

Mr. WATTS. Is mined for a number of different enterprises, is it not?

Mr. LINDSAY. Yes.

Mr. WATTS. I am not too familiar with the field, but in some of those enterprises I would assume that it might have to go through more processes than, let us say, for ordinary brick. And for pottery it might have to go through a little different process.

Do you visualize, in your regulations of mining, for a man that is in the pottery clay business that he might take his processing one step farther than would be necessary for a fellow in the brickmaking business?

Mr. LINDSAY. I am not so sure that I know enough about the differences between shipping pottery clay and brick clay right now to be able to answer that question.

Mr. WATTS. Well, as a general proposition, do you mean by this legislation to allow a fellow to add in those costs or calculate in those

costs that he has to encounter in getting his raw product in the condition where it can be marketed?

Mr. LINDSAY. We do. I understand, for example, in china clay drying would be necessary.

Mr. WATTS. Then if it should be necessary to do some pulverization of clay, drying it out, you contemplate that the law would be broad enough or the regulations drafted under it would be sufficient to permit that to be done, provided that is necessary in order to market the raw clay?

Mr. LINDSAY. That is correct.

Mr. WATTS. Thank you.

The CHAIRMAN. Mr. Alger will inquire.

Mr. ALGER. This is something of a mixed blessing, Mr. Lindsay. I am one of those who would like also to be over on the floor. There is a very interesting debate going on right now, and I think it accounts for some of the absenteeism. I do not intend to ask more than elementary questions. I recognize how much I have to study to understand this depletion problem. Naturally, the Texans have somewhat of an interest in oil and gas, and, therefore, I have been raised in an environment with depletion allowances, I guess, all my life.

I see in your statement you mention that hearings will be held later—and I have not had the privilege of talking to the chairman about what this program is, yet this is a part of this hearing, so I am in a position of recognizing that you bring the subject up and yet it is not the subject of the hearings at the moment.

Is that correct, Mr. Chairman?

The CHAIRMAN. That is not covered in this particular hearing, that subject is not.

Mr. ALGER. Then I shall just pass over this.

I see that you say this on page 17:

> Legislation is needed in order to provide consistent treatment for oil and gas with that suggested for minerals generally.

Yet I am struck by all of your testimony that to give treatment for any mineral, you must recognize the unique characteristic of that mineral or ore, is that correct?

Mr. LINDSAY. That is correct.

Mr. ALGER. I saw in your statement, as an example, that under treatment processes considered as mining, in the case of crude minerals or ores, crushed, grinding, sorting, screening, wash and drying, and so forth. So I think of butane and propane as being sort of a sorting process. Maybe they are not. But this, as I would think, is a unique characteristic of oil and gas.

The gentleman from Texas has pointed out earlier the uniformity of interests that we have. We have consistency, we have a uniformity of interest between minerals, we have a unique characteristic. I have also heard earlier today something about arbitrary selection of minerals.

Is that correct in times past?

Mr. LINDSAY. Yes, sir.

Mr. ALGER. So the very least we have now, as I see it, is to work out a formula, if that is what we are going to do, that involves consistency, uniformity of interest, uniqueness, arbitrary—well, I am just wondering.

Mr. LINDSAY. May I say, Mr. Alger, that we wanted to get into the record our statement on the oil and gas so that our proposals would be before the industry and they will be on notice and come in and make any comments they wish.

Mr. ALGER. I am sure they appreciate that, and I certainly do. I have one final thought, Mr. Lindsay. What we are talking about now is return of capital, is that correct, in depletion allowance? And this is, by definition, a matter of incentive, is it not, the reverse being that if you could not get your capital back, your incentive is apt to be destroyed; is that correct?

Mr. LINDSAY. Yes. I think it is a combination of recapture of capital and incentive.

Mr. ALGER. And incentive, of course, is the very basis, as I understand it, of the continuation and the growth of business. Is that not correct?

Mr. LINDSAY. That is correct.

Mr. ALGER. So the very least we are talking about in this committee, if I am grasping this at all, is the very continuation and growth of our industry which we call now free enterprise, and, therefore, it demands at the least a very careful study by this committee. Is that not correct?

Mr. LINDSAY. That is correct.

Mr. ALGER. So I would be right in assuming, then, that when we get into all of this depletion, including later to oil and gas, we should give it very careful attention.

Mr. LINDSAY. Yes.

Mr. ALGER. Thank you very much.

The CHAIRMAN. Mr. Metcalf had another question.

Mr. METCALF. Mr. Chairman, this morning when I was asking Mr. Lindsay about iron ore, I used taconite for an example. The kind of iron ore I had in mind was not taconite. As I look this over, just where does taconite go in this bill?

Mr. LINDSAY. It would be in 3(c), on page 2.

Mr. METCALF. That was my assumption.

Mr. LINDSAY. That would be beneficiation by concentration, and any additional process if necessary. It is about four or five lines down in 3(c), on page 2.

Mr. METCALF. The iron ore I was thinking of they dig with shovels and grind it, separate it with a magnetic process, and then pelletize it with heat in order to ship it. That is very close to the taconite process as I have seen it up on the Mesabi Range.

I assumed it would come in those processes under (c). As I look down, I think it might come under (d).

Mr. LINDSAY. Well, it is intended to come under (c).

Mr. METCALF. It is intended to come under (c). Let us say that if the Beaver Head Mining Co. owns the land in fee and goes in with shovels and digs it, digs this low-grade iron ore, grinds it, separates it by magnetic process, and then pelletizes it for shipment, all of those would be covered by this bill in depletion?

Mr. LINDSAY. Yes.

Mr. METCALF. Suppose Beaver Head Mining Co. does not own it, but they lease from individuals around who do not own it in fee, and they dig it, bring it in, and go through the same process. Where is depletion granted?

Mr. LINDSAY. They would share it between the lessor and the leesee in that instance.

Mr. METCALF. Is there any difference between leases measured by a royalty per ton on the ore and fee ownership in granting depletion allowances?

Mr. LINDSAY. Fee ownership without a lease would involve a situation in which there would be no sharing. But if there was a lease involved, then there would be a sharing, based on a formula.

Mr. METCALF. It would be a sharing where there was a lease involved, measured on a royalty basis?

Mr. LINDSAY. On a royalty basis.

Mr. METCALF. Thank you.

The CHAIRMAN. Mr. Ikard will inquire.

Mr. IKARD. This morning, Mr. Lindsay, we were speaking of stone. As I remember, you indicated that sawing, polishing, and other processes would be part of the manufacturing process. It occurred to me that I wanted to ask you again about sawing the stone. Generally, it seems that that would be a mining process, or it has been so considered.

Mr. LINDSAY. It could be. That is right on the line, so to speak.

Mr. GLASMANN. To the extent that the sawing would be quarrying, that would come under it.

Mr. LINDSAY. If you did not need the sawing to cut the stone, but you were merely shaping it, that would be one thing.

Mr. IKARD. I had in mind the actual removal.

Mr. LINDSAY. Removal? That would be a mining process, then.

The CHAIRMAN. Mr. Simpson.

Mr. SIMPSON. Mr. Lindsay, is it grasping for power on the part of the Department of Treasury that leads you to ask for legislation which will place this whole question of the amount of depletion industry gets in the hands of hired employees of the Department?

Mr. LINDSAY. No, it is not. In fact, I think most of us wish the problem would disappear.

Mr. SIMPSON. You mean you would like not to have depletion at all?

Mr. LINDSAY. No, I do not mean that. But I wish it were not such an administrative problem as it seems to be.

Mr. SIMPSON. I know you do not mean to remove depletion from our tax law. But how do you think the country would profit from the uncertainties that are always incident and arise when individuals are given what can amount to the question of life or death over an industry? I am advised in some of the fields, certainly with respect to some corporations, the amount returnable or retainable by the taxpayer as a result of depletion allowance does represent economic life or death to the company.

How can you suggest responsibly to this committee that we, in carrying on our duties, can delegate that to the Department of the Treasury?

Mr. LINDSAY. Let me say this: I think the main problem, the main administrative problem, gets into this question or proportionate profits, what portion of the profits is attributable to the mineral product as opposed to the manufactured product.

That problem is present under existing law. That problem will continue to be present under our proposed statute. We do not get rid of that problem by enacting this legislation. But I do not think we necessarily magnify the problem either.

We hope by a rule that is flexible and sufficiently within the control of the taxpayer, that the taxpayer can choose his own method.

Mr. SIMPSON. Do you mind if I interrupt? The flexibility is in the hands of the Treasury Department.

Mr. LINDSAY. It is the same kind of a question as depreciation. Ordinarily, any reasonable basis picked by the taxpayer will not be overturned.

Mr. SIMPSON. Have not the courts resolved this question today? We have been years in reaching the points where we are today. But have not the courts finally and at last reached an interpretation of the law 1954?

Mr. LINDSAY. They have resolved the question within certain narrow factual situations, but that has left unresolved many other questions.

Mr. SIMPSON. I would not accuse you, my friend, of setting up strawmen, but I have to say that I cannot agree that envisaging this thing as spreading and including the entire automotive industry, for example, and taking the finished product, being a completed automobile, as being a possibility, that the court would reach a point like that in considering depletion on minerals.

That to me appears to be the wrong kind of arguing and I do not think you mean it, seriously. I just suggest, and I am going to argue this way to the committee at the proper time, that for the first time we do have now a situation of stability in this field of depletion.

Certainly we have comparative stability. The Department has been told now by the courts just where depletion is to apply, the amount of money, based upon decisions at hand, is not too large, in my judgment.

Certainly it is a small price to pay for stability in a field where cases have been hanging open for years, 6, 7, or 8 years, because we have not been able to reach an administrative decision. I think we might advisedly retain something that gives us an element of certainty rather than adopt the terrific uncertainty that we would find from the approval of a new approach to this question.

That is why I cannot agree with you. I wish you would come in with firm standards and tell us exactly what you want done in these different areas. I could listen and give it some consideration. But I personally cannot view with favor any proposal that further increases the position of power of individuals to hold life or death authority over any of our industries.

If you care to comment, you may.

Mr. LINDSAY. Thank you, Mr. Simpson. I would like to be able to agree with you, but I cannot, that the courts have finally settled this question for all taxpayers and all minerals in a definitive manner. Most of the decisions that are clear involve cases in which the crude mineral could not be sold, and the facts so stipulated.

That leaves a variety of questions which are difficult to resolve where the crude might be sold but is not, or is sold by another taxpayer but not by the particular taxpayer. These questions are now being litigated. Some of them are being resolved in favor of the Government.

Also, we think that the trend of the decisions is creating not stability, so to speak, but discrimination as between taxpayers, favoring the integrated producer and manufacturer. We do not intend by our

proposed legislation to put more power in the hands of the administration, the executive branch of the Government, and would welcome all the help we can get in the statute to spell out rules to minimize administrative problems.

Mr. SIMPSON. That is all.

The CHAIRMAN. Are there any further questions?

If not, Mr. Lindsay, let me direct your attention, if I may, to a copy of the proposal, the bill, in order that I may understand what it is that you are proposing to do with respect to each of these items.

On the first page of your draft, there is the first of two setcions of the whole, is there not?

Mr. LINDSAY. Yes.

The CHAIRMAN. You propose two things here. First of all establish depletion rates for certain clays, and then in (*b*) to better define, in your opinion, treatment processes considered as mining.

Are those the two things overall other than the effective date proposed in the bill?

Mr. LINDSAY. Yes.

The CHAIRMAN. With respect to the first, when you amend paragraph 3 to read as it does in your proposal compared to the way (*b*) (3) reads in section 613 at the moment, you strike out "ball clay, bentonite, china clay, sagger clay," do you not, from (3)?

Mr. LINDSAY. Yes.

The CHAIRMAN. Is bentonite comparable to or competitive with the others that you are striking from that?

Mr. LINDSAY. To some extent, I believe, yes.

The CHAIRMAN. I did not think it was. I did not think it was in all respects competitive. But yet when you take it out of (3), you put it down into (3)(B), along with ball clay, sagger clay, clay used or sold for use for purposes dependent on its refractory properties.

Does bentonite fit into those categories? I am asking for information. I do not remember.

Mr. LINDSAY. It was my understanding that it did.

The CHAIRMAN. Is it only used or sold for use for purposes dependent on its refractory properties, or does it have other properties?

Mr. LINDSAY. Well, I think it has other uses.

The CHAIRMAN. I meant uses and not properties.

Mr. LINDSAY. It is used as a well drilling mud and as a catalyzer in refining crude oil.

The CHAIRMAN. That was my recollection. What happens to bentonite for those purposes in this change?

Mr. LINDSAY. If it is not sold for use dependent on its refractory properties, it would still have the 15 percent rate.

The CHAIRMAN. It has 15 percent now for all purposes. If it is used for some purpose other than its refractory properties, it would still get 15 percent.

Mr. LINDSAY. That is partly right. Whether used for its refractory properties or not, bentonite would get 15 percent, unless used for one of the purposes named in our amendment to 5(B).

The CHAIRMAN. That is also true of ball clay, china clay and sagger clay, is it not?

Mr. LINDSAY. Yes; that is correct.

The CHAIRMAN. Do they have other uses as well as refractory properties?

Mr. LINDSAY. I believe some of them might. I am not sure about that.

The CHAIRMAN. What I am getting at is this: You have looked to see whether or not you are continuing to be cognizant of the competitive conditions that may exist with respect to these particular items?

Mr. LINDSAY. Suppose these other clays are used for ordinary bricks or similar products for which ordinary clay is suitable. They would have the 5 percent rate, just as ordinary clay. But if they are used for anything else, then they would have the 15 percent rate.

The CHAIRMAN. Under your amendment to paragraph 5, you split the first subparagraph. Where it is now (A), it would become A and B under your proposal. You take brick and tile clay out of A, as I understand, and then you redefine clay under B, used or sold for use, and so on, for purposes of the 5 percent, is that right?

Mr. LINDSAY. That is correct.

The CHAIRMAN. Where do you get bentonite in the 5 percent? That is what I am trying to find out about.

Mr. LINDSAY. Bentonite is a clay, a form of clay.

The CHAIRMAN. So your definition of clay used or sold for use in the manufacture of building or paving blocks, drainage, roofing tile, sewer pipe, flower pots and kindred products could include bentonite?

Mr. LINDSAY. That is the intention, yes.

The CHAIRMAN. So any commercial use that bentonite would have, would either develop a 5 percent allowance or a 15 percent allowance?

Mr. LINDSAY. That is correct.

The CHAIRMAN. I wanted to be certain about it. I am not using that as an example. But I think I understand your other changes.

Subparagraph (C) in the draft is not changed at all from the way it is in law presently as (B). You have taken refractory and fire clay out of paragraph 6 for 15 percent because you have already rearranged it and included it at another point?

Mr. LINDSAY. That is correct.

The CHAIRMAN. Then what are you trying to do now with respect to certain clays in this 1(a) part of your draft?

Are you trying to change anything, or are you trying, by redefinition, to describe the same situation which exists today? In other words, clay used for refractory purposes and the 4 other clays are to have 15 percent; but clays used for ordinary brick, and so forth, are to have 5 percent.

Mr. LINDSAY. This is a change in the statute.

The CHAIRMAN. What is the change?

Mr. LINDSAY. The draft would allow 15 percent for (1) bentonite, china clay, ball clay, sagger clay, and (2) other clay used for its refractory properties, except that all would get 5 percent where used to manufacture building or paving brick, sewer pipe, and kindred products. The change is to make the rate of percentage depletion dependent in many instances on the use to which the material is put. Under existing law, refractory clay would have 15 percent even though it was used for ordinary bricks, and the taxpayer was competing with another clay miner who was making ordinary bricks.

The CHAIRMAN. In other words, it is a question now of what kind of clay it is rather than the use to which it is put in determining whether it will be 15 percent or 5 percent.

Mr. LINDSAY. That is right, except that you could not use any kind of clay for a purpose that requires refractory properties.

The CHAIRMAN. Is that be cause the refractory clay used for purposes of making brick is in competition with other clay that might serve that purpose?

Mr. LINDSAY. It could be. You may have in your clay bed two kinds of clay and use both for ordinary brick in competition with somebody else.

The CHAIRMAN. In other words, your thought here is that by this change and rearrangement, you can establish a more equitable competitive position between the two. Is that the point?

Mr. LINDSAY. That is the point.

The CHAIRMAN. I have been trying to find out.

Mr. MASON. On that point, however, the refractory clay is scarce and much more costly than common clay used in brick.

If refractory clay is only to get the 5 percent if it is used in brick because it is in competition with the 5 percent clay that is used in brick, the owner of it is going to lose money, if he uses it for brick.

The CHAIRMAN. I was not going into the question of justification, Mr. Mason, at this point. I was merely trying to find out what the Treasury was trying to do in this draft.

Now, let me ask you with respect to subsection (b), if I may, Mr. Lindsay. Most of the questioning today has been directed toward that part of the draft, I know.

You divide that up into three parts. The first part amends paragraph 2 of section 613(c), is that right?

Mr. LINDSAY. That is correct, the definition of mining.

The CHAIRMAN. You set forth a new definition of the term mining.

Mr. LINDSAY. Yes. We eliminate the words "treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable product or products."

The CHAIRMAN. That is all you are doing, is taking that out?

Mr. LINDSAY. Rephrasing the provision accordingly so that it will make sense.

The CHAIRMAN. That may make sense to some people as it now stands. Do you mean where it makes more sense to the Treasury and the Internal Revenue Service, is that a better way to put it?

Mr. LINDSAY. Well, I was not thinking substantively then so much as grammatically. We made a minimum amount of changes after taking out those words.

The CHAIRMAN. What language do you put in?

Mr. LINDSAY. The language that appears on page 2: "The term mining means extraction," et cetera.

The CHAIRMAN. Before we get there, on page 1 of this which we have before us, take me down to the line in paragraph (2) where you change it.

Mr. LINDSAY. Are you looking at the code?

The CHAIRMAN. I am looking at your draft. I see what you take out of the code. I want to know what you put in.

Mr. LINDSAY. We put in "the treatment" in the second line of paragraph 2, "the treatment processes considered as mining described in paragraphs 3 and 4."

The CHAIRMAN. That is the change that you are making?

Mr. LINDSAY. That is the change.

Mr. GLASMANN. Mr. Chairman, also in the first line we changed the word "includes" to "means."

The CHAIRMAN. Pardon?

Mr. GLASMANN. In the first line, in the present statute we have the term "mining includes." We changed that to the term "mining means."

The CHAIRMAN. That is a very important change, is it not? The word, "means" and the word "includes," that is important. I was coming to that in a few minutes. You say this is more easily understood or simpler or something. But you have already lost me. You have paragraphs 3 and 4 involved in your substitution. Let us go to 3 and 4.

Paragraph 3 is redesignated paragraph 5. Paragraph 4 is deleted. Then you put 3 in, treatment processes considered as mining, and then 4 is treatment processes not considered as mining.

You get rather specific, do you not, in two, when you change the word "includes" to "means"?

Mr. LINDSAY. Yes.

The CHAIRMAN. Then when you get over to paragraph 3, you try to set forth treatment processes considered as mining. In (A), you make no change.

Mr. LINDSAY. No change.

The CHAIRMAN. In (B) you make no change?

Mr. LINDSAY. No change, correct.

The CHAIRMAN. In (C), you have materially changed the existing situation through the change in language? Or what have you done?

Mr. LINDSAY. Yes. We have combined (C) and (D) in old paragraph 4.

The CHAIRMAN. You have combined (C) and (D) of present law for purposes of the new (C) here, but you have made some changes in the language, have you not?

Mr. LINDSAY. Yes, we have.

The CHAIRMAN. What are those changes? What is there here that is not in (C) and (D) of the code, or what is left out of (C) and (D)?

Mr. LINDSAY. You will notice old (C) specifically mentions "in the case of iron ore, bauxite," et cetera, and in the new (C) we merely say "in the case of all other minerals or ores."

The CHAIRMAN. That leaves ball and sagger clay out, does it not?

Mr. LINDSAY. No, because ball and sagger clay are not included in (A) and (B). They come within the definition of "all other minerals."

The CHAIRMAN. This, then, is not limited to minerals as differentiated from nonmetallics? You are including nonmetallics and metallics in the word "minerals"?

Mr. LINDSAY. Yes.

The CHAIRMAN. You have all of these included, then, in your language, but what changes have you made with respect to these processes that are mentioned in the code? Have you changed any of them?

Mr. LINDSAY. Mainly we have rearranged them; in addition, we have applied loading for shipment across the board, whereas it had rather limited application before. It was provided only in (C) before and not in (D).

The CHAIRMAN. Actually, then, in the process, you are not proposing to change anything that is in (C) and (D)? You are not

proposing to leave anything out that is in the nature of an allowed process under existing law.

Mr. LINDSAY. That is correct.

The CHAIRMAN. But you are proposing to extend the term "loading for shipment" beyond the provision of (C) and (D)?

Mr. LINDSAY. That is correct.

The CHAIRMAN. And to go across the board?

Mr. LINDSAY. Across the board, exactly.

Mr. GLASMANN. We also put in words like crushing, grinding, screening, and washing as allowable processes, which are taken from past administrative practice.

The CHAIRMAN. Would you repeat that, please?

Mr. LINDSAY. In the third line of (C) we have added the words "crushing, grinding, screening, washing, and drying," which are taken from past administrative practice, and which are not in the present statute.

The CHAIRMAN. They are in your regulations but not in the statute?

Mr. LINDSAY. Regulations or rulings.

The CHAIRMAN. Does the inclusion here take anything away from (C) and (D) as they are in existing law?

Mr. LINDSAY. It is not intended to.

The CHAIRMAN. It is not intended to, I understand. But actually, does it or not? Are there any other processes that are in your regulation not specifically stated in (C) and (D) that are not included in the words, "crushing, grinding, sorting, screening, washing, and drying to remove free moisture?"

Mr. LINDSAY. We think not, because we say any additional process if necessary to bring the mineral or ore in form or condition suitable for shipment. That would take care of some processes that may be necessary, but which are not specifically named in the statute.

The CHAIRMAN. Is that a part of (C) or (D) at the moment?

Mr. LINDSAY. I do not see that same language in (C) or (D) now.

The CHAIRMAN. Then so far as processes are concerned, that may well take you beyond in this draft (C) and (D) of existing law and beyond your regulations?

Mr. LINDSAY. It takes us beyond the specific words in the existing statute.

The CHAIRMAN. That is what I meant.

Mr. LINDSAY. But not beyond what we understand existing practice to be.

The CHAIRMAN. I want to come to practice in a minute.

You have changed (C) to (D) and you have added to it "the furnacing of quicksilver ores" which in existing law is included in paragraph (D) anyway.

Mr. LINDSAY. Yes.

The CHAIRMAN. So, as a matter of fact, there is no change in existing law, and your provision (D)?

Mr. LINDSAY. That is right.

The CHAIRMAN. Now we come to treatment processes not considered as mining. I would imagine that herein lie most of the questions. This you do not accept as a process within your definition of the word "mining."

Mr. LINDSAY. That is right.

The CHAIRMAN. Electrolytic deposition. Do you have a definition of that?

Mr. LINDSAY. That is picked up from (D) of existing law.

The CHAIRMAN. Well, there is a change, then. Under existing law it says that is a process in mining.

Mr. RUSTIGAN. It is listed as "not including as an ordinary treatment process."

The CHAIRMAN. What is it that you have added to this that is not included now? Roasting is.

Mr. LINDSAY. That is not a mining process.

The CHAIRMAN. Roasting is, but calcining is not included, is it? Or is it?

Mr. LINDSAY. It is not included in the 1954 code.

The CHAIRMAN. Thermal—well, we are in trouble because the court does not agree with some of the regulations. I am trying to get an exact understanding of what is here that is not in the law or what change is made.

Mr. LINDSAY. Thermal or electric smelting was in the law before.

The CHAIRMAN. Yes, I see that.

Mr. LINDSAY. We also have added polishing, fine pulverization, and blending with other materials.

The CHAIRMAN. And treatment affecting a chemical change, that is new?

Mr. LINDSAY. That is new.

The CHAIRMAN. Thermal action, that is new?

Mr. LINDSAY. Yes.

The CHAIRMAN. And molding or shaping, that is new, is that right?

Mr. LINDSAY. Unless such processes are otherwise provided for in paragraph 3.

The CHAIRMAN. That applies to all of them, does it?

Mr. LINDSAY. Yes.

The CHAIRMAN. Well, are they or are they not in paragraph 3?

Mr. LINDSAY. They are to the extent that they are necessary for eliminating waste materials, as part of beneficiation.

The CHAIRMAN. This material in existing law that you retain in the process under C of beneficiation by concentration may include, then, treatment affecting a chemical change?

Mr. LINDSAY. It might, yes.

The CHAIRMAN. When will it and when will it not?

Mr. LINDSAY. It depends on the method used. They may have to roast to separate out the waste. There are a number of different ways of eliminating waste. One would be by gravitation, where there are different specific gravities or weights in the minerals, in the properties. Another is by flotation. There may be heating processes necessary, or amalgamation. There are different ways of separating out the waste, some of which might include elements of the processes otherwise disallowed. When they are necessary to separate out the waste, they are allowable.

The CHAIRMAN. What I am getting at is this: Are you going to be in an argument with the taxpayer if the taxpayer has need for this language, treatment effecting a chemical change, in order to come to either (ii) or (iv) of paragraph C, beneficiation by concentration and the processes necessary thereto, that is (ii); or any additional proc-

esses necessary to bring the mineral ore to form and condition suitable for shipment, that is (iv).

What I am thinking about is what Mr. Metcalf mentioned, the situation of iron ore, low grade iron ore that might be processed in part, at least, through this magnetic treatment, and you specifically spelled that out, magnetic means, in (C). But what if you obtain the same end result with respect to another mineral through use of a chemical process that you obtain in the case of iron ore through the magnetic means and the other allowable processes.

Mr. LINDSAY. Leading to the same end result?

The CHAIRMAN. Yes. You end up with a nodule of another type of mineral. Is there argument as to whether or not this chemical change is within the meaning of (C) if there may be some other process other than chemical change that somebody else might use to get to this result?

The taxpayer has used it and somebody else may use something else. Would that be a possible reason for concern or denial?

Mr. LINDSAY. It may be that the statute can be clarified in this connection. But it is intended to include those processes necessary to bring the product into condition and form suitable for shipment even though it might produce a chemical change. It might have a chemical change where acid is added to melt an ore and dissolve out the impurities.

This also might involve a chemical change.

The CHAIRMAN. But you do not intend to deny under this provision the same application of the depletion allowance that you described in the case of iron ore with Mr. Metcalf to some other mineral when the end product is the same, a little nodule of this mineral compared to a little nodule of iron ore, if it has gone through beneficiation by concentration—that is what it is—if in that process of getting to the end result something else has occurred which may be within (4)(A), because you say that that is essential under (C) to get to this end result.

Mr. LINDSAY. That is right. That is what is intended by the language, "unless such processes are otherwise provided for in paragraph 3."

The CHAIRMAN. You may want to give further consideration to (4)(A). Certainly the committee will want to understand just what it is that we may be changing, what we may be denying.

Here is what I am concerned about, that we are not establishing a hard and fixed rule with respect to various processes that we presently know about, and discard the possibility of some worthless mineral being marketable through some process that may be developed in the future that would not be described by any of these words that we have in (C).

There are many, many low grade ores in this country for which we have been seeking additional methods of benefication. Some progress is being made with respect to several of them I understand, and we must be careful that we do not unintentionally create a circumstance under which depletion allowance could not apply at least to the same point with respect to them that it would apply under this to some other mineral.

Do you see my point?

Mr. LINDSAY. I see your point and I agree with you.

The CHAIRMAN. What does (4)(B) on page 3 do?

"Notwithstanding any other provisions of this subsection, any treatment process which follows a process that is not considered as mining, will not be considered as mining for the purpose of this subsection."

These things I am talking about may, to the Internal Revenue Service 5 years from today, be considered other than mining.

Do we create confusion rather than certainty in this catchall (4)(B)?

Mr. LINDSAY. This is a very important provision, and it needs careful attention. I am sure it can be improved. The purpose is to prevent grinding, say, of clinkers, rather than the grinding of the stone before hand.

There are many processes which would be treated as mining processes in order to bring the crude ore into suitable form for shipment, and the like. But similar type processes can later be applied in a manufacturing process.

Without some kind of a saving clause such as this, we might have a fair amount of confusion and litigation. It is true that we have already discovered that there are some problems introduced by this paragraph (B), and we certainly want to do everything we can to clarify it.

The CHAIRMAN. You will begin the program, of course, with respect to the taxable years beginning after December 31 of last year?

Mr. LINDSAY. Exactly.

The CHAIRMAN. Mr. Lindsay, what are the primary areas of dispute with taxpayers? I notice in table 1 you show something like $200 million involved in these 112 cases involving limestone, limestone clay, and shale. You said $297 million altogether, did you not?

Mr. LINDSAY. Yes, sir.

The CHAIRMAN. It looks like most of your problem, then, is with respect to the point at which depletion shall apply in the case of limestone or limestone or clay shale used in producing cement?

Mr. LINDSAY. Yes.

The CHAIRMAN. Tell me how you propose to change for the future the point at which depletion will apply in the case of these two items of limestone, or clay shale.

Mr. LINDSAY. Take limestone, first. Under the Dragon Cement Co. case, the cutoff point is the manufacture of cement.

The CHAIRMAN. After it is put in a sack ready for shipment?

Mr. LINDSAY. Yes.

The CHAIRMAN. That has the effect of the Dragon case?

Mr. LINDSAY. That is right. I have forgotten whether bagging was involved in that particular case, but it did apply to the finished product, such as it was in that case.

We would permit under our cutoff point to be treated as mining processes, the quarrying, the crushing, and grinding, and screening. We would not include as a mining process the calcining and the final manufacture of the cement.

The CHAIRMAN. You would not permit what? Calcining?

Mr. LINDSAY. Calcining.

The CHAIRMAN. Is that the reason you put the word "calcining" in 4(A)?

Mr. LINDSAY. Yes. That is the burning of the limestone in the kiln to produce the lime.

The CHAIRMAN. What kinds of limestone is used for cement? I know there is chemical limestone or metallurgical limestone; I know there is agricultural limestone. What kind of limestone is used in cement?

Mr. LINDSAY. I would say, generally, calcium carbonate rock type. I might ask Mr. McGinnis if he can answer.

Mr. McGinnis said any kind can be used for cement.

The CHAIRMAN. Do you mean this kind we spread on the farm for agricultural purposes?

Mr. MCGINNIS. Any kind.

The CHAIRMAN. Well, what kind is it? Do they use the agricultural or the chemical kind or the chemical or metallurgical kind?

Do they use all of it?

Mr. MCGINNIS. They use whatever is most convenient, and if it is outside of the range of the chemical analysis that they want, they add enough clay or shale or enough high-grade limestone to bring it to the chemical composition they want.

The CHAIRMAN. There is quite a difference, is there not, in the possibilities of sale of these high-grade limestones, such as are defined as being usable for chemical purposes? I am thinking in terms of the kind of limestone that might be used by the aluminum industry in the manufacture of aluminum. I have always understood that only a high grade of limestone can be used in that case.

It has other uses, of course. But that, I always understood—that type of limestone produced a much higher price than the other that I referred to as agricultural limestone.

Mr. MCGINNIS. It may, depending on location. If you have no aluminum manufacturing facilities convenient, the effect on the price of limestone is insignificant.

The CHAIRMAN. I see your point. In other words, this is considered when it is near an aluminum plant to be better and draws a higher price.

Mr. MCGINNIS. Yes.

The CHAIRMAN. In the absence of such aluminum plant, it might draw the same price as the agricultural limestone or be used as agricultural limestone?

Mr. MCGINNIS. Yes.

The CHAIRMAN. So you say the cement industry, then, gets for itself that which is the nearest and most available?

Mr. MCGINNIS. Yes.

The CHAIRMAN. If it finds that it is not of high enough grade, it will add some that is to the total to bring it up?

Mr. MCGINNIS. Yes.

The CHAIRMAN. Does it have a value?

Generally speaking, does any of that which is used by the cement industry have a value as it is originally produced?

Mr. MCGINNIS. Most limestone has a value of some sort. There are some limestones which are so impure that they are not suitable for construction or roadwork or material of that nature.

Yet they may be just right for making cement. That has been the case in the Dragon Cement Co. decision, when they call that cement rock, because that is about all it is good for.

The CHAIRMAN. Let us take this kind of limestone I know about, the agricultural limestone. They just quarry that and crush it in my

State and we buy it and put it on our farm. I pay them so much a ton for it. What additional has to be done to that before it is limestone suitable for use in the cement industry?

Mr. McGINNIS. That?

The CHAIRMAN. That is right.

Mr. McGINNIS. All that is necessary is to add enough clay or shale to bring it down to the chemical range that they want.

The CHAIRMAN. They do not have to do anything to the limestone itself?

Mr. McGINNIS. Well, in making cement you grind it to a very fine powder.

The CHAIRMAN. I understand; but I am talking about what process does the limestone—I am not talking about the process of the cement company, I am talking about through what process does the limestone itself have to go in order for me to be able to sell it? What do I have to do to it in addition to what I have to do to sell it for farm use?

What additional do I have to do in order to have a market for it with the cement manufacturer?

Mr. McGINNIS. If you are going to sell it on the farm, you have gone to the limit. You do not have to do any more.

The CHAIRMAN. That is where my depletion would apply, then, if I sell it myself?

Mr. McGINNIS. Yes, with the possible exception of the fine pulverization.

The CHAIRMAN. I am selling it. We ground it up before we took it to the manufacturer. You say I have a market for it on that farm.

Mr. McGINNIS. I thought that was your proposition, that you had a market for it as agricultural limestone.

The CHAIRMAN. I am saying we sell it and use it for that purpose. But what do I have to do additionally to that which is satisfactory for agricultural purposes in order to induce the manufacturer of the cement plant in my town, say, to buy it? Do I have to do anything?

Mr. McGINNIS. No.

The CHAIRMAN. In other words, I have a market with the cement manufacturer for the limestone that I have ground and made available for agricultural purposes if there is a cement plant in my area?

Mr. McGINNIS. It would be suitable for making cement yes.

The CHAIRMAN. So my depletion would be at that point. I have sold it.

Mr. McGINNIS. Yes.

The CHAIRMAN. If the cement manufacturer owns that same kind of a limestone deposit, the Dragon case says that in place of it applying at that point of grinding and pulverizing, at which I got my depletion allowance, that it will apply in that case on the cement itself?

Mr. McGINNIS. Yes, but you are talking about two different limestones. The Dragon Cement Co. case said that that limestone was so impure that it was not suitable for agricultural limestone. It would be substandard.

The CHAIRMAN. Was that the background and basis for the decision in the Dragon case?

Mr. McGINNIS. The background was that there was no market for it.

The CHAIRMAN. There was no market on the farm?

Mr. MCGINNIS. For the limestone.

The CHAIRMAN. Well, does the Dragon case mean that in the instance that I have used as an example, that depletion would occur at the level of the cement or the finished product, or in the case of the Dragon Co., as it did in the instance when I sold it to the Dragon Co., or would it apply in the example I gave at that level?

Mr. MCGINNIS. If you sold a high-grade limestone, agricultural limestone, to a cement company, at that point that would be your depletion unit or basis.

The CHAIRMAN. I understand that.

Mr. MCGINNIS. If the cement company was also mining its own limestone, we would give them depletion on the same basis that that stone was purchased.

The CHAIRMAN. From me?

Mr. MCGINNIS. Yes.

The CHAIRMAN. That is what I am getting at. There is nothing in the Supreme Court case that prevents you from doing that?

Mr. MCGINNIS. No; not yet.

The CHAIRMAN. The Supreme Court case says, though, that it has to go to the level of the finished product cement, because up to that point it has no value. Well, did it or did it not, anywhere along there, have any value?

Mr. LINDSAY. That was a court of appeals case. The Supreme Court denied certiorari. The Supreme Court did not decide the case.

Mr. RUSTIGAN. It is not that it has no value, but that it has no market.

The CHAIRMAN. It has no market. What are you doing in this? Saying that you will fix it at a certain level even though there may not be any market for any comparable item?

You are talking here in the case of an integrated situation, are you not?

Mr. LINDSAY. Yes.

The CHAIRMAN. You fix it at a level below the finished product in the case of the integrated situation even though there may not be any market for the product at the level at which you fix depletion?

Mr. LINDSAY. That is correct.

The CHAIRMAN. Is that what you are doing?

Mr. LINDSAY. That is what we are doing.

The CHAIRMAN. That is decidedly contrary to what existing law says, is it not?

Mr. LINDSAY. It is certainly contrary to the Dragon Cement case.

The CHAIRMAN. Let us just be frank. I am not being at all facetious, but it seems to me that when you look, that we were thinking in terms of the first marketable condition, commercially marketable. That means a market at which you can obtain a price, does it not?

Mr. LINDSAY. If you permit the producer of cement rock, which has no market, as such, to base his percentage depletion on the finished product of the cement, you are granting that taxpayer a larger percentage depletion than you would the taxpayer who is producing limestone, which is rarer, perhaps, and which has a market and which he goes on to manufacture into cement.

The CHAIRMAN. I am not disputing the justification of your position. I am not getting into that. I am trying to see if actually, as a matter of fact, we are not merely overcoming a court decision but we are limiting this expression of commercially marketable mineral product which is in existing law.

Mr. LINDSAY. That is why I wanted to mention at the outset of this afternoon's session that when Congress introduced that language, "commercially marketable product" in 1943, the committee report stated, and Senator Thomas stated on the floor, that they thought they were not changing existing administrative practice, and existing administrative practice at that time would have not permitted any taxpayer to apply the percentage depletion to the manufactured product even though he had no market for the raw material.

The CHAIRMAN. You understand I am not trying to defend the court, because I do not do that. They can take care of their own problems.

What I was thinking about, though, is whether or not what we are doing here is trying to overcome some glaring situation that the court has had. It seems to me that if there is a problem in the area, it is in respect to language of existing law.

Mr. LINDSAY. I agree with that.

The CHAIRMAN. That is what I wanted to find out. Now we are faced, then, with the proposition of whether or not we think existing law has established the point in some instances where depletion may apply at too late a point in the processing.

You would go from the sale price in these instances backwards, would you not?

Mr. LINDSAY. Yes; normally. But if there was a market of the crude mineral available, the taxpayer may choose to use that market to show what portion of his gross income is attributable to the mineral.

The CHAIRMAN. That is the point I wanted to bring out. If the taxpayer does not elect, then you would start at the sale price of the finished product?

Mr. LINDSAY. We might look at the existing market for the minerals, if there was an existing market, with stated prices.

The CHAIRMAN. Either of you could?

Mr. LINDSAY. Yes. And whichever is most appropriate and convenient under the particular circumstances.

The CHAIRMAN. Is that not likely to create about as much confusion as you could have under provisions of existing law? I can well recognize that you can have confusion under it now. Why not work it out on some basis that we apply a uniform and standard rule so everybody knows in all the various district offices that are dealing with this, that we are going to start at the sale price and work back. It should not be that in some offices it will be the practice of doing that and in other offices the practice will be to take some level as being a market price, when in reality the taxpayer himself is not going to agree that that is the level of the market price.

Mr. LINDSAY. Maybe we could do that. I believe the 1939 code regulations had such a provision.

The CHAIRMAN. That is what I had in mind. If the taxpayer wants to supply you with information that the market value is something less and that is the way you should do it, rather than start

at the top and come down, then, of course, you could or could not go along on that basis, depending upon the showing made by the taxpayer to that effect.

Mr. LINDSAY. Yes. It seems to me that there should be some flexibility for the taxpayer.

The CHAIRMAN. That is what I am trying to get, but let us have it that it is not flexibility between district offices, but flexibility within district offices. Do you see any of my points?

Mr. LINDSAY. Yes.

The CHAIRMAN. Mr. Mason?

Mr. MASON. I want to try to make an illustration of what your point was. You take limestone, you grind it and pulverize it, you sell it to the farmer to spread on his land. That is one process.

The price you get for it is the price upon which the depletion rate is the base. Then you take a low-grade limestone that is not fit for that, nor fit for anything else, but to make cement with. You quarry it, grind it, you mix other things with it to bring it up to the proper chemical content.

Then it is still not marketable in any sense of the word. Then you burn it or calcine it in a big furnace and make it into clinker.

Well, it is still not marketable as clinker. You could not even dispose of a pound of it. It is not fit for any use at all. Then you grind it up into powder and then it is marketable. Then it is cement, after it goes through this burning process and that mixture to get the right chemical content. Then it is marketable.

Under the bill that they have they say, "We will cut it off before you burn it." Well, it is absolutely useless; it is no good; it could not be used for anything. So they are then violating the law which says the first commercially marketable point.

The CHAIRMAN. Mr. Lindsay, I appreciate very much your frank answers. I wanted to get a complete understanding of what you intended in this draft. I have used these two or three minerals as examples of what you might have intended.

Are there any further questions?

Mr. HARRISON. Did Mr. Lindsay have an answer to what Mr. Mason stated?

Mr. LINDSAY. What Mr. Mason says is correct in that we would in that case reduce the percentage depletion base so it would not be based on the finished product, but on the amount attributable to the mineral used up to a particular point, up to a particular cutoff point. It is true that that means that there would be relatively little percentage depletion permitted to that taxpayer.

If it were otherwise, that taxpayer, with a low-value, cheap product, would be getting more percentage depletion than somebody else who had a more valuable product, more valuable kind of limestone, and perhaps a rarer kind of limestone. If the product is not salable as it is produced from the ground, that must mean that it is relatively cheap and has very little value.

One wonders how much we should worry about percentage depletion in that case. To give value, you have to apply manufacturing processes and you are, in effect, permitting that particular taxpayer to have percentage depletion based on his manufacturing, not on his mining.

Mr. HARRISON. Does the manufacturing process consist of anything except reducing the size of it, grinding it, or burning it? What does it consist of other than that?

Mr. LINDSAY. Yes, blending in some cases. Mining processes would consist, in this instance, of the quarrying, the crushing and grinding, and the screening.

The CHAIRMAN. Mr. Lindsay, this entire area is one of the most discussed areas of our entire Internal Revenue Code.

Mr. Baker suggested this morning, as I understood it, that it might be impossible for the Congress to do justice, both from the point of view of the public and the individual taxpayer involved in the area of depletion allowance, without giving overall consideration to this subject, including the rates.

The purpose of this hearing was not for a discussion of rates, but for the specific purpose of seeing where the rates that are applicable in the code with respect to these minerals should apply, the place that that rate should apply.

I do think that that is a distinct problem from that of rate. It may be that Mr. Baker's observation is perfectly correct in that you cannot do adequately in this area without giving consideration to both aspects of the problem, but let me suggest this thought for your answer, if I may.

If we are not mindful of how people view certain provisions of law and whether or not we are successful in sustaining a sound theory for the provisions of law, then we perhaps hasten the time when the overall consideration that Mr. Baker alluded to will have to occur.

Would you think that that is worthy of our consideration?

Mr. LINDSAY. I certainly think it is worthy of our consideration, but if it leads to the conclusion that we should not attempt now to solve this cutoff problem, I would be very much concerned.

The CHAIRMAN. I am not referring to that at all. What I am saying is just the antithesis, that if we cannot solve these problems of cutoff, then certainly the taxpayers who are not involved in these subject matters are going to become concerned as to whether our overall theory of depletion is satisfactory. Many of them have already reached the conclusion that it is not.

Mr. LINDSAY. I agree with you completely.

The CHAIRMAN. I think it most important that we do try to resolve this separate and distinct from the matter of rates if we can, in part at least, in an effort to try to preserve for some people rates which are now enjoyed.

Would you agree with that?

Mr. LINDSAY. I would agree with that, too.

The CHAIRMAN. Are there any further questions?

If not, again, Mr. Lindsay, yet me thank you, sir, and those who have accompanied you to the hearing, for your explanation of the Treasury's position in this area and for your explanation to me of what you intended in the draft of the bill.

Thank you, sir.

Mr. LINDSAY. Thank you, Mr. Chairman.

The CHAIRMAN. Our next witness is an old friend of this committee representing the American Mining Congress, Mr. Lincoln Arnold, who is engaged in the practice of law here in the District of Columbia.

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Mr. Arnold, I do not know what this organization is paying you in the way of fee, but if you are working as hard for them as you did for this committee, I know you will earn it.

STATEMENT OF LINCOLN ARNOLD, CHAIRMAN, TAX COMMITTEE, AMERICAN MINING CONGRESS

Mr. ARNOLD. Thank you very much.

The CHAIRMAN. You can quote me on that.

Mr. ARNOLD. Thank you again.

The CHAIRMAN. You are recognized, Mr. Arnold.

Mr. ARNOLD. Mr. Chairman and members of the committee: I appear before you as chairman of the tax committee of the American Mining Congress. The American Mining Congress has in its membership producers accounting for a major part of the production by the various branches of the mining industry including coal, ferrous and nonferrous metals, and industrial minerals.

In the very short time following the release of the proposed draft of legislation submitted by the Treasury Department to specify the treatment processes to be considered as mining for the purpose of the percentage depletion allowance, the tax committee of the American Mining Congress has given this problem its careful attention. While we find the proposed draft is objectionable in a number of respects, and requires amendments, the American Mining Congress does not oppose the basic position taken by the Treasury Department in its proposed legislation—that is, the elimination of marketability as a test to determine what processes constitute mining.

In recent cases the courts have ruled that a producer of minerals—as to which the statute does not specifically bar certain processes—may take depletion based on the value of the first commercially marketable product which he produces, without regard to the type of processes required to arrive at such product. This first commercially marketable product test can lead to the result that although two taxpayers are producing the same end-product, and are using identical treatment processes, one of them may be considered as engaged in mining with respect to all of his processes whereas the second, because of the existence of a market in his area at an earlier stage of processing—whether or not he can or does sell any of his product at that stage—may be considered as engaged in mining only until he reaches that earlier stage.

However, in applying the marketability test, some courts have ruled in effect that if the production from a mineral deposit is sold at various stages of processing and the producer can show that he sold all that he could economically sell at each stage, then the portion sold at each stage is the first marketable product for that portion of the output of the mine, so that there are as many first commercially marketable products as there are stages of processing at which he sells.

Thus, under this so-called saturation approach, if the taxpayer can overproduce his market at each stage of his processing, all of his processing would qualify as mining for percentage depletion purposes.

The Mining Congress has reached the conclusion that the marketability test not only allows results which go beyond the original concept of the percentage depletion deduction, but also can produce unin-

tentional discrimination between taxpayers employing the same treatment processes to produce the same end-product.

While removal of the marketability test admitted eliminates the possibility of greater depletion allowances for major segments of the mining industry—I might add parenthetically that I am referring to much more than the cement industry—we concur in the Treasury's recommendation that this test be eliminated for the future in order that the percentage depletion concept may be continued on a sound and reasonable basis.

We take this position, however, only on the understanding that the removal of the marketability test will be combined with an adequate enumeration in the statute of those treatment processes which properly are to be considered as mining.

It should be noted that even under the existing law the marketability test is not applicable in certain instances. Smelting and refining are disallowed as ordinary treatment processes under section 613(c)(4)(d) in the case of lead, zinc, copper, gold, silver, and other ores which are not customarily sold in the form of the crude mineral product.

Thus, in the case of copper which the mine owner carries through in an integrated process to refined copper, the smelting and refining are not considered as ordinary treatment processes even though he can show that he had no market for the product of his mine without carrying it through to the refined metal.

On the other hand, it is clear, and has always been so intended, that the treatment processes which are specifically named in the statute can be applied by the mine owner and not be eliminated for depletion purposes even though he might have had a marketable product at an earlier stage.

For example, an owner of a coal mine is entitled to treat cleaning and breaking of coal as mining even though he might have had a market for all or part of the output of the mining without such cleaning and breaking.

In presenting this position of the American Mining Congress, I cannot claim that all of our members subscribe to it. A substantial majority of our cement producers oppose the proposed elimination of the marketability test, and I understand the views of these producers will be presented to you separately during these hearings. We do not, of course, attempt to restrict in any way the right of our members to present their individual views.

Our decision that the Treasury should not be opposed on its basic position as to the elimination of the marketability test rests upon, and is very dependent upon, two fundamental assumptions as to the Treasury's intent and objectives.

The first assumption is that under the amendment there will still be allowable and treated as mining not only all processes which are specifically named as ordinary treatment processes under existing law, but also the many processes unnamed in the statute which the Treasury, since the enactment of section 124(c) of the Revenue Act of 1943—which first defined ordinary treatment processes—has recognized as allowable processes under long-standing administrative decisions and practices.

For example, the processes required in the extraction of bromine from natural brines, the agglomeration of certain concentrates, and the processes after cyanidation of gold ores in producing the Dore bar.

The second assumption we make is that the elimination of the marketability test, in determining what is mining, will have no effect whatsoever on the continued use of the methods and practices developed in the past in computing the gross income from mining where a product is sold after being treated by a process which does not qualify as mining process.

The regulations in effect since 1932, when percentage depletion was granted to metal mines, have provided, as amended, that if a mine owner processes his mineral by nonmining processes, and if there is no representative market or field price for the mineral product as beneficiated only by the ordinary treatment processes actually applied, then the gross income from mining shall be computed by working back from the representative market or field price of the first marketable product resulting from the nonmining processes applied.

Under this work back, the costs and proportionate profits attributable to the nonmining processes are eliminated to arrive at the gross income from mining, except that—and this is an important exception—if the taxpayer establishes to the satisfaction of the Commissioner that another method of working back clearly reflects the gross income from mining, such other method will be used.

Thus, under the regulations in effect for all periods since 1932, if a mine owner smelts his concentrated copper ores and sells the blister copper, and if there were no representative market or field price for the copper concentrates, which would be the cutoff point, the amount received for the copper blister, less the costs and profits, if any, incurred after the concentrating, would constitute the gross income from mining.

I would say that roughly 90 percent of the depletion allowance taken on copper is obtained by working back, by the producer, from the refined copper, because generally there is no market or field price at the cutoff point.

About 90 percent of the copper is produced by integrated owners of mines, integrated right through to the refining.

This long-established method of working back to eliminate income from nonmining processes should not be disturbed in any respect by the elimination of marketability as a test in defining mining processes. But to avoid any possible confusion in this repect, we urge that the work-back rule, as set forth in section 39.23(m)-1(e)(3) of regulations 118, be written into the statute itself at an appropriate place in section 613(c) of the Internal Revenue Code.

Under the proposed legislation the objective is to list all of the mining processes insofar as possible, without leaving anything to be determined by any general test such as marketability. In its proposed bill the Treasury attempts to state the processes which will be treated as mining. We cannot attempt—at least in the time for study which has been available to us—to try to tell this committee what processes applied in the case of each of the many individual minerals should be treated as mining processes. The special problems concerning individual minerals will undoubtedly be presented to you by those directly concerned.

In my testimony I shall confine the balance of my remarks to those areas where the Treasury Department's proposed legislation encroaches—in most cases, we believe, unintentionally—on the rights

which exist under the procedures and tests previously employed by the Treasury Department.

One of the most difficult problems posed by the draft is that it is impossible to name and classify all of the countless little actions and processes properly considered as part of the mining process. I mean that without regard to any marketability test.

For example, in the process of removing impurities from coal there are many procedures available, with physical and economic considerations governing the particular method used. Naturally, the statute cannot list each and every method, and each and every part of such methods, so the proposed statute properly covers all parts of all such methods by the single word "cleaning."

However, additional language is required to avoid any possible difficulty arising with field offices over the particular methods used to accomplish the cleaning of coal. For example, the cleaning of coal by washing requires the application of heat for drying. Similar problems occur throughout the entire mineral field.

Another illustration of the problem is found in the northern areas, where it is frequently necessary to use special thawing equipment which applies infrared heat to the sides of ore cars so that the frozen ore can be unloaded at the concentrating plant.

Obviously, this type of handling is the sort of thing which should not have to be listed in the statute. But to be sure that this, and other things of this nature, are covered, we ask that you make applicable to all minerals and ores a provision that "mining" includes not only the listed permissible processes but also the processes necessary, appropriate, or incidental thereto, even though such processes, such as thermal action, are otherwise on the prohibited list.

Under this suggested amendment, it will be clear, for example, that if roasting of ores is required for the process of cyanidation—which is a listed process—or for the process of leaching—which is a permissible process—or if the primary purpose of such roasting—which is otherwise disallowed—is to improve the results obtained from such permissible processes, such roasting will be allowed.

A closely related and even more serious problem involves the proper classification of unknown future processes. New ways are constantly being found to do things we don't know how to do today, and new ways are constantly being found to do in a more efficient manner the things we do today by processes which will eventually be obsolete.

In drafting legislation today we must be careful that the language will accommodate the use by taxpayers of new and improved technology; otherwise, the tax laws in this area would stop the clock on progress and freeze technology at the present stage of development.

In order to avoid the stultifying of technological progress through the operation of static tax laws, the bill should provide that, in addition to the listed processes, mining shall include "processes or combinations of processes which as to the particular mineral involved produce substantially equivalent results" to the listed processes.

A similar problem arises under the proposed Treasury draft which, after listing five methods of concentrating, adds the phrase "substantially equivalent processes." To avoid any ambiguity as to whether this phrase refers to result or to technique, the phrase should read "processes substantially equivalent in result."

The need for maintaining the flexibility necessary to progress is especially evident with respect to beneficiation by concentration and with respect to beneficiation by cyanidation, leaching, crystallization, or precipitation. The present law permits combinations of these processes, and our suggested amendments will retain this flexibility as well as making it clear that radically new methods of achieving the same results will be permissible.

A good example of the need for flexibility to take care of future progress may arise in the case of uranium. The methods of concentrating uranium ores today are varied and include the so-called resin-in-pulp method, the so-called solvent extraction method, and others. Today's methods of obtaining the uranium concentrate are basically combinations of specifically listed processes or processes substantially equivalent thereto, and therefore are permissible under present law and under the Treasury's proposed draft.

However, in this rapidly advancing field it is entirely conceivable that the future will see a radically different method of concentrating uranium. If that does happen, the new method should be permissible, without regard to lack of similarity to today's methods, so long as the end result is the uranium concentrate.

The Treasury draft improperly limits beneficiation by concentration to "the application of processes solely for the purpose of eliminating waste, or separating the mineral or ore from other minerals or ores." This should be changed to read, "the application of processes for the primary purpose of eliminating waste or separating the mineral or ore from other minerals or ores."

Further the listed methods of concentration should be preceded by the word "including" so revenue agents will more clearly understand the intent of Congress in this respect.

Still other changes should be made for the purpose of having it clear in the statute that the mining processes listed are not intended to be narrowly interpreted and rigidly exclusive. The law should be properly drawn so that the various field offices of the Internal Revenue Service will understand that Congress did not mean to bring about extended controversy over each and every phase of the mining operation.

In proposed section 613(c)(2) the word "means" should be changed to "includes." Since the draft eliminates the marketability test and contains a comprehensive listing of processes which are not to be considered mining except as they constitute a part of or are necessary to a listed process, the Government does not need the protection of the word "means."

In proposed section 613(c)(3)(C), the words, "where applied to crude minerals or ores" should be deleted. Certainly, any of the listed processes should be allowed without regard to the fact that other permissible processes may already have been utilized. The phrase would appear to have the literal meaning that only one of these processes could be used, and we feel certain Treasury is not intentionally asking for that result.

The words "drying to remove free moisture" in proposed section 613(c)(3)(C) should be changed to "drying to remove moisture." In the course of necessary drying, it will be almost impossible to determine whether some inherent moisture is driven off, and if so, how much.

Also, in proposed section 613(c)(3)(C), there is contained the following provision as an allowable process:

(iv) any additional process, if necessary, to bring the mineral or ore to form and condition suitable for shipment;

The processes referred to in (iv) are those processes which are necessary to bring the mineral or ore to the physical form and condition in which it is capable of being transported as distinguished from those processes applied to make the mineral or ore salable.

We ask you to change the word "necessary" to the word "utilized," and to insert before "capable" the word "readily." Since anything can be put in a container of some kind or other, it could be said that anything can be shipped without further processing. We feel sure the Treasury Department intends the quoted provision to be interpreted in a reasonable manner, but under the literal words of the proposed provision difficulty might easily result.

Further, the quoted provision should be made applicable across the board—to all minerals. As it stands in the proposed bill, it would not apply to coal and sulfur, which have always been allowed such processes under present law.

Again, in proposed section 613(c)(3), there is contained the following provision, which should be made applicable also to coal and sulfur:

The term "loading for shipment" shall not include the cost of packaging unless otherwise provided for under (iv), nor shall it include the cost of containers, bags, or any similar items;

Unless this provision is made applicable to coal and sulfur, inequities will result.

For example, when sulfur is loaded into bags and then the bags are loaded for shipment, the cost of loading the bagged sulfur would not be permitted under this provision, although it seems clearly intended that in such an instance only the cost of the bags, and the cost of putting the product into the bags, where not necessary for shipment, is to be excluded.

In proposed section 613(c)(3), a slight change is necessary to correctly express what we believe to be the intent of the Treasury Department.

The proposed language treats as mining only the processes "applied by the mine owner or operator with respect to the minerals or ores extracted from the ground by him." If the Treasury Department intends, as we believe, to exclude here only the processing of purchased minerals, then this phrase should be changed to read: "applied by or for the mine owner or operator with respect to the minerals or ores extracted from the ground by or for him."

Without some such change, the provision might be interpreted to prohibit a mine owner from hiring anyone to do any part of his mining or processing on a contract or toll basis.

In the case of sulphur recovered by the Frasch process, the words "cleaning" and "agglomeration," allowable processes under existing law, should be added to the specified processes in view of the approach of the new bill to list as specifically as possible the allowable processes.

We urge that the prohibition of "fine pulverization," contained in proposed section 613(c)(4), be eliminated, and that the term "grinding," in proposed section 613(c)(3)(i), be clarified by adding the parenthetical phrase," (including pulverization to any degree)."

As the Treasury Department's proposal now stands, it properly allows fine pulverization where it is a part of, or necessary to, a mining process—such as pulverization in the course of concentrating by flotation. We believe that "fine pulverization," rather than being excluded under some circumstances, should be a specifically permissible process.

Grinding as such is a continuous operation, and it is impossible to determine where "grinding" stops and "fine pulverization" begins—as a matter of fact, the mining industry has generally considered that "fine pulverization" is included in the term "grinding." The Treasury Department in recent years has endeavored to treat "fine pulverization" as being something separate and apart from "grinding," but no court decisions have upheld this interpretation.

From a practical standpoint, it is impossible to determine the cost of "fine pulverization," even if it were possible to define "fine pulverization." Unless "fine pulverization" is treated as an allowable process, some taxpayers, such as those producing finely ground minerals, may well find themselves faced with the impossible task of determining what percentage of the product became "fine" before a given stage and what percentage did not become "fine" until after that stage—with the stage itself being necessarily an arbitrary one. We urge that the statute specifically recognize pulverization to any degree as being a part of "grinding."

The present law permits the sintering of iron ore to bring to shipping grade and form. The phrase "shipping grade" connotes a degree of quality or marketability, and "shipping form" connotes an improvement for the purpose of improving the shipping characteristics.

Since under the Treasury's draft of the proposed amendment, the term "shipping grade" as well as the marketability test are being eliminated, we believe that the agglomeration of iron ore or iron concentrates should be specifically allowed in the proposed section 613 (c) (3) (D)—particularly since sintering at the mine or concentrating plant has long been considered by the Service as a proper process.

There should also be added, in Treasury's proposed section 613 (c) (3) (D), the following provision:

in the case of calcium carbonates, shale, and other minerals used in making cement—all processes used in the production of the kiln feed.

As we previously stated, our basic premise is that the new legislation should not only retain the processes specifically allowed under the present law but also leave undisturbed the unnamed processes recognized by Treasury as mining processes.

In the case of materials used for making cement, the kiln feed was the cutoff point under Treasury's interpretation of the law. Last year the Treasury in substance urged the kiln feed as the cutoff point when it asked Congress for legislation on this subject.

We assume that Treasury has not changed its intent in this respect—and we believe there should be no change of intent in this report—but language like the above is necessary to assure that this intent is carried out.

With respect to "blending with other materials," as contained in Treasury's proposed section 613(c) (4), there is need for clarification. The Treasury's draft would exclude blending with other materials as a mining process.

We assume, of course, that the term "blending with other materials" does not include the mixing of different grades of coal with each other, the mixing of lean ore with rich ore, the mixing of brines, the mixing of different grades of limestone, such as the mixing of dolomite with calcium carbonates, or the mixing of ores by a miner who mills not only the ores from his own mine but also the ores of other producers on a custom or toll basis.

Neither should the phrase prohibit the addition of grinding aids, or the addition of conditioning agents to aid beneficiation by concentration, and things of that nature. Further, the phrase "blending with other materials" should not apply, and we assume it would not apply, to the mixing of clay or shale, et cetera, with calcium carbonates in connection with the grinding process prior to the kiln feed stage in the production of cement.

Our last problem is our most vexing one—the "sudden death" provision in proposed section 613(c)(4)(B), under which any process which is normally treated as "mining" is not to be so treated if it follows a process which is not considered as "mining."

Obviously, the tax law should not operate to prohibit progress or economical operation. For example, if the producer of a given mineral is obtaining his product solely through the application of "mining" processes, he gets all of those processes, including "loading for shipment."

If this producer then finds that his customers desire a slight improvement in his product, which requires the application of processes not considered "mining," under the proposed draft the producer will no longer get "loading for shipment" because of the application of the "sudden death" clause.

In circumstances such as these, we believe the producer should at least continue to be allowed his "loading for shipment," even though it occurs after a process which he is required to eliminate from "mining."

Naturally, we do not contend that a producer of coal who makes coke should get either the conversion to coke or the loading of the coke. But there are many circumstances today where an intervening nonmining process is thrown out of the computation without affecting the permissibility of the remainder of the mining processes.

A striking example of the dangers in such a provision as the "sudden death" clause comes from the sulfur industry. Until a few years ago, the production of sulfur by the Frasch process required the use of fresh water. However, a technological breakthrough permitting the use of sea water has recently taken place, making available large sulfur deposits that could not otherwise be mined.

The use of sea water requires an inexpensive filtering operation at the mine, to remove the salt from the molten sulfur. This filtering operation occurs prior to pumping to vats and subsequent allowable treatment processes.

Even with the addition of the words we have already suggested—providing that "mining" includes the processes necessary, appropriate, or incidental to the listed permissible processes—it might be considered by some field agent that this filtering operation was not an allowable treatment process and, if the agent were sustained, the "sudden death" provision would disqualify all the normal processing of

sulfur—although we cannot believe that the Treasury intends such a severe result.

We believe that with the elimination of the marketability test, the Treasury will be protected against unreasonable results without any need for the "sudden death" clause. However, if the Treasury is adamant about the need for some further protection in this regard, and if this committee agrees with the Treasury, then we urge you to give us time to find out from Treasury exactly what things they feel require such a clause, so that we may have an opportunity to work out with them, and with your staffs, language that will do the best job possible of protecting the interests of the Government without encroaching on the existing rights of industry and without preventing the continuing growth of a dynamic mining industry.

We have not had time, since the Treasury's proposed legislative draft was made public, to investigate completely all the many situations which undoubtedly exist where long-standing rights might be curtailed by the proposed legislation. In fact, we have not had time to consider adequately the proper correction of the known situations of that type.

However, we want to express our desire to confer and advise with Treasury representatives and your staffs, for the purpose of eliminating as many unintended hardships as possible, before this committee begins its deliberation on this matter. We hope you will allow time for this to be done.

Since this committee is considering revising the definition of "gross income from mining," we believe it is appropriate at this time to urge, as we did last year, that you revise section 613(c)(2) of the code by changing from 50 miles to 100 miles the amount of allowable—without the consent of the Secretary or his delegate—transportation from mine to treatment plant.

As we have stated before, improving technology is making available vast reserves of the minerals which are so necessary to the continued well-being of this country, but that same advancing technology is constantly widening the distance from the mine to available treatment plant sites.

We also ask you to provide that more than 100 miles of transportation to treatment plant will be permitted where the Secretary or his delegate finds that the "physical or other" requirements—rather than the present provision, "physical and other" requirements—are such that the ore or mineral must be transported a greater distance than the mileage specified. It is our belief that the present provision has been interpreted in a very restrictive manner, and we think the change here suggested would be a proper step in keeping up with changing conditions.

There is attached to my statement a memorandum dealing with the definition of "taxable income from the property," which in the interest of time I will file rather than read. However, it appears to us that this is an appropriate time for consideration of this important matter, which is so closely related to the definition of "gross income from mining."

I hope you will give it your consideration. Thank you very much.

Mr. BOGGS (presiding). Does that conclude your statement?

Mr. ARNOLD. Yes, sir.

(The document referred to follows:)

DEFINITION OF TAXABLE INCOME FROM THE PROPERTY

When percentage depletion was first extended to mines in 1932 the allowance was limited to 50 percent of the taxpayer's "net income from the property," and this language has continued without change until in the 1954 code the word "net" was changed to "taxable." The phrase "net income [now taxable income] from the property" has never been defined in the statute.

We believe the original intent of Congress was to limit the percentage depletion allowance to 50 percent of the net income from the property from which the ore was produced, regardless of the form of its ownership (whether by a corporation, partnership, or individual) and regardless of the manner in which the operation might have been financed. To meet this standard, it is appropriate that deduction should be made for those expenses directly connected with the production of income from that property and for such indirect or overhead expenses as definitely contributed to the production of income from such property. The deductions in computing net income from the property should not be increased by expenses applicable to other property (any more than the income from that property should be increased by other income); by interest paid on indebtedness (any more than interest received should be included in income from the property); by taxes based on or measured by income, capital stock taxes, and other charges which are not costs of producing net income from a particular property (but depend upon the form of property ownership, the amount of net income of the taxpayer from all sources, methods of financing, etc.). Nevertheless, under present practice the Internal Revenue Service holds such items deductible in computing "taxable income from the property" for percentage depletion purposes, and the courts have sustained such practice.

Present practice results in inequitable and unreasonable results as between taxpayers. For example, two different taxpayers in identical situations except for the method of financing may have identical properties producing at the same cost and the same profit. Nevertheless, the taxpayer who must borrow funds for his operations will, under present practice, receive the benefit of a smaller percentage depletion deduction than that available to the other taxpayer who has sufficient capital to operate without borrowing.

Again, two different taxpayers with substantially identical operations, producing at the same rate of profit, may be located in different States, one in a State which imposes an income tax and the other in a State which has no income tax. Under present practice, the taxpayer in the State which has an income tax will have a smaller Federal percentage depletion allowance than the taxpayer in the State with no income tax.

In order to limit deductions in the computation of the depletion allowance to those items which have a direct bearing upon the production of income from the property on which the percentage depletion is allowable, we recommend the addition of the following new subsection to section 613 of the code, or its equivalent in purpose and effect:

"(e) *Definition of Taxable Income from the Property.*—As used in this section the term 'taxable income from the property' means the gross income from the property (computed without excluding any amount on account of bonus exhaustion, rents or royalties), less the allowable deductions directly attributable to the mineral property upon which the depletion is claimed and the allowable deductions directly attributable to the processes described in paragraph (4) of subsection (c) of this section insofar as they relate to the products of such property, including operating expenses, rents and royalties, development costs properly chargeable to expense, depreciation, property taxes, losses sustained during the taxable year, etc., but excluding any allowance for depletion. Such expenses or deductions shall not include expenses or deductions attributable to, or arising out of expenditures on, other property or assets, irrespective of whether such property or assets are income producing or active. Deductions are not attributable to, or arising out of, particularly properties, processes or assets, such as general overhead, shall be fairly allocated to all properties, processes and assets whether active or inactive. The term 'general overhead' as used herein shall be deemed to mean the overhead relating to the property but shall exclude deductions and expenses of financial overhead of the taxpayer such as interest, taxes based on or measured by income, capital stock taxes, and the like."

Mr. BOGGS. Are there any questions?

Mr. MASON. The question I have is a statement that you presented a very sensible analysis of our problem.

Mr. ARNOLD. Thank you, Mr. Mason.

Mr. BOGGS. Mr. Ikard?

Mr. IKARD. As I understand the Treasury representatives this morning, they conceded that it might be possible to find a neutral process for this section, which is neither mining nor manufacturing, and which would not involve disallowance of a subsequent mining process.

I wonder if you might comment on that, please.

Mr. ARNOLD. I think that if we sat down in a good drafting session, we could probably find something that would probably satisfy the legitimate desires of both the Treasury and the taxpayers in this area. I think that the sudden-death clause is such a harsh remedy that it should be junked.

But, at the same time, I can understand that there are problems, such as those raised this morning. I do not believe that it is possible to draft something that you can say settles all problems beyond all arguments. As you know, I drafted for this committee, and I thought I drafted some things that were crystal clear, but some of those provisions still ended up in the courts.

It is impossible to draft anything so that if someone wants to read it with a wrong intent—well, at least he can take you to court. I admit that it is not possible to draft these amendments, even with the most time given to it, so that you can say, "Now we are free of trouble."

That is impossible, but I believe that something can be worked out, Mr. Ikard, that would make sense.

Mr. IKARD. Thank you very much.

Mr. BOGGS. Mr. Byrnes?

Mr. BYRNES. I would like to say that Mr. Arnold, as has always been the case, has been very helpful with his statement.

Mr. BOGGS. Mr. Baker?

Mr. BAKER. Mr. Arnold, at the bottom of page 9 and the top of page 10, where you discuss the term "loading for shipment shall not include the cost of packaging unless otherwise provided for, nor shall it include the cost of containers, bags, or any similar items."

At the top of page 10, I can see that as to sulfur, but how does that apply to coal?

Mr. ARNOLD. We just feel that any provision on shipment should apply all the way across the board. This particular provision as Treasury has it does not apply to coal and sulfur.

Perhaps it would have no application. I do not know that coal is ever put into bags prior to shipment.

Mr. BAKER. That was my point. I had no idea of it being put into containers.

Mr. ARNOLD. It may be that this sentence could be confined to sulfur as a practical matter, but sulfur is bagged, and we want to be sure that in that case you would only eliminate the cost of the bags.

Mr. BAKER. Regardless of who it applied to, you think if it is an ordinary part of the process, that they should be allowed for packaging?

Mr. ARNOLD. Our position has been that the cost of bags is not something that is subject to the allowance for percentage depletion. Let me put it this way:

We found no one in our tax committee who objected to this provision in the Treasury's bill except in the respect as we have stated it here. If it is necessary to put something into bags in order that it can be shipped, the cost of putting it into the bags should not be eliminated, but the cost of the bags or the containers themselves, to my mind, is going beyond the bounds of the percentage depletion allowance.

Mr. BAKER. The cost of putting it into the bags?

Mr. ARNOLD. If it is necessary for the shipment, it should be allowed; yes.

Mr. BOGGS. Mr. Alger, have you any questions?

Mr. ALGER. Mr. Arnold, I am certainly interested in what you say. The language problem is culminated, in my mind, on the top of page 7. It strikes me from what little I know of this committees' operations, and certainly you know better than I, that we cannot look at the future, but we have to keep reevaluating, will we not, and have new language every year as new processes are uncovered?

Mr. ARNOLD. I would hope that this is not necessary. I believe that the bill can be drafted so that when you get new techniques to accomplish the same result, the bill can make it crystal clear that those are to be allowed even though they are different in technique.

If it is a new method of concentrating ores, it ought to be allowed, even though it is not named as one of the methods of concentrating. I would not say that you can draft this bill now so that you will never be called upon to look at it again, or to have some amendments because of advancing technology, but I think it can be drafted so you will not be bothered with it every session of Congress.

Mr. ALGER. On page 7, you say, to avoid any ambiguity the phrase should read, "processes substantially equivalent in result."

What do you suppose the court would do with that one? There is unlimited latitude. Perhaps I am looking for trouble, but I just think that the court would wonder about that.

Mr. ARNOLD. Let me say that this statute, since 1948, has allowed beneficiation by concentration and the statute has listed five methods, and then has ended up with, "or equivalent processes."

I may be wrong, but I do not recall that that phrase has ever been in court. There are methods of concentrating which are only equivalent in result not in method to those described. All that the present law really means, I think, is processes equivalent in result. At least we have not had trouble with that phrase, equivalent processes, in the past.

I will say that there may be some cases pending in the courts that I have not heard about. But it is one of these areas in which you do not have something that is nailed down tight and I do not believe it should be nailed down tight.

Mr. ALGER. I guess we can agree as you point out that the Internal Revenue Service should understand Congress. Congress and the Internal Revenue Service might get together but the courts would not understand either of us.

Mr. ARNOLD. Yes.
Mr. ALGER. That is all.
Thank you.
Mr. BOGGS. Thank you very much.

Our next witness is Mr. Howard J. Carey, Jr., representing the Salt Producers Association, a member of the executive committee of that association.

Would you be good enough to identify the gentlemen with you, Mr. Carey?

STATEMENT OF HOWARD J. CAREY, JR., A MEMBER OF THE EXECUTIVE COMMITTEE OF THE SALT PRODUCERS ASSOCIATION, ACCOMPANIED BY FRANK J. MADDEN, L. M. McBRIDE, AND ROBERT GERRIE, COUNSEL, SALT PRODUCERS ASSOCIATION

Mr. CAREY. Mr. Chairman and members of the committee; on my right is Mr. Frank J. Madden. On my left are Mr. L. M. McBride and Mr. Robert Gerrie, who are acting as counsel for the Salt Producers Association in the presentation of this material.

I am appearing at a member of the executive committee of the Salt Producers Association, and I am here as the authorized spokesman for the dry salt producing industry.

As this point I should probably distinguish between this industry and those which use or produce and use salt in the form of brine.

Since the 1939 code, the industries enjoying percentage depletion have been governed by what is now section 613 of the 1954 code. That section has been construed fully and consistently time and time again by the United States district courts and by the courts of appeal for almost every circuit. This construction has been endorsed, at least in part, by the Supreme Court's denial of certiorari in a number of those cases. Consequently, industry now knows how to compute its depletion and, so nearly as I can determine, the only reason for the proposed amendment by the Treasury Department rests on the fact that almost uniformly the cases have been decided in favor of industry and against the restrictive construction insisted on by the Treasury Department.

In any event, even with the short time available for a study of the proposed amendment, it becomes abundantly clear that the Treasury Department's proposed legislation will produce a number of impossible results. The present depletion section provides for depletion being computed on a basis that includes "ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products." Instead of this understandable and flexible standard of industry processes, the Treasury Department in its proposed amendment has sought to define the permitted industrial processes on a completely fixed and frozen basis. The net result must be, then, that if production and treatment processes are changed or improved in the future and fail to comply with the static pattern proposed by Treasury, then to that extent the price of the progress will be the loss of depletion.

Again, if one member of a particular industry follows religiously the fixed definitive pattern of the Treasury amendment, then that member will gain the full measure of depletion provided by the statute,

even though all other members of the industry may be pursuing wholly different methods of extraction and processing, which fall outside the fixed standards proposed by the Treasury Department, and thereby have forfeited all or most of their depletion. By the same token, and because of certain provisions which I will subsequently mention in more specific form, an industry member may lose a large measure of what would otherwise be his allowable depletion if at some stage in the extraction and treatment processes he injects, voluntarily or otherwise, a particular process which does not fall within the precise nomenclature of the proposed amendment. To this should be added the fact that from the rewriting of section 613, discrimination will become the order of the day, with certain industries enjoying depletion benefits disproportionately greater than those enjoyed by other industries operating under the same depletion percentage, and this because of the ill-chosen pattern of the Treasury's effort to define what it now conceives to be the mining and extraction processes of the various depletable industries involved.

Aside from these generalities as to all industries, the problems presented by the proposed amendment are probably more acute in their effect on the salt industry because of the unique processing features of that industry. To demonstrate this uniqueness, I am filing with the committee as additional material a series of flow charts which graphically demonstrate the continuity of salt production from the moment it comes from the ground, either by dry rock salt mining or by brine-well operations, until it is loaded onboard cars, trucks, or barges. At one state in this continuous flow, some bulk salt of various grades is diverted into the loading operation, but the balance of the flow moves through packaging equipment and then into the loading stage. The present section 613 permits the use of a workable basis for the computation of the depletion allowance for the salt industry, but the proposed amendment would have the effect of trying to knife through this continuous process at some point short of loading, with the result that the allowable depletion could be computed only by the use of the so-called proportionate profits or cost rollback method. There can be little doubt but that the use of such a formula in the salt industry is unworkable in that it accords no recognition to the realities of salt production.

Again addressing myself specifically to the salt industry, the proposed amendment would clearly prohibit the inclusion of package material the depletion base. Here again the salt industry is probably entirely unique. As far as we know, salt is the only mineral mentioned in the statute which is subject to the Pure Food, Drug, and Cosmetics Act, and which is used in human consumption or in the preparation of foods for human consumption.

The Federal Food and Drug Administration requires salt to be labeled if it is to be used for human consumption, such as table salt, or used industrially for the processing of food for human consumption. Likewise, almost all of the 49 States have laws requiring the labeling of salt for use in the animal industry.

Because no one has yet been able to devise a means of labeling salt in bulk form, the salt industry has no alternative to the necessity of packaging its product for human consumption, industrial food usage, and animal consumption, and that process is an integral part of the

continuous processing of salt from underground to the loading stage. To adopt the Treasury proposal would be to ignore the basic economics of the salt industry.

Still another peculiarity sets the salt industry apart from all other depletable industries.

The extraction and treatment processes of the salt industry are entirely mechanical or physical in nature, with the original underground mineral being sodium chloride and with the end products still being sodium chloride. However, two of these key mechanical processes involve crushing and screening, and the necessary and inevitable result of these two processes is a multiplicity of grade sizes of sodium chloride, regardless of whether or not the crushing and screening is applied to salt produced by dry rock mining or hydraulic mining.

The multiplicity of products is broadened still further by the fact that different crystal structures of sodium chloride emerge from the production of salt by the dry rock salt mining method, by the vacuum pan method, and by the open grainer pan method. This fact of product multiplicity, therefore, of necessity resists the straitjacket treatment which would be imposed by the proposed amendment as though only a single product were involved.

The generalities of my statement to date can readily be supported by a more detailed analysis of the proposed amendment. If this analysis is confusing to this committee, it can be attributed to the fact that the amendment itself is so replete with confusion and contradictions. Nevertheless, I feel compelled to burden the committee at least with some of this confusion and with a few of the more obvious contradictions as they affect the salt industry.

Although many of the details tend to overlap, perhaps some clarity can be added by paragraph enumeration.

1. The present section 613 provides in paragraph (c)(2) that the term "mining" includes—and I emphasize the word "includes"—not merely the extraction of the ores or minerals from the ground but also the ordinary treatment process referred to earlier in my statement.

The amendment in paragraph (c)(2) defines the term "mining" as follows: "The term 'mining' means"—and I underscore the word "means"—"the extraction of the ores or minerals," and so forth.

In other words, the present act provides for the inclusion of processes normally applied by an industry, so that general industry standards as they change from time to time will always prevail. In sharp contrast, the proposed amendment makes it completely clear that only the specifically named processes may be employed in the depletion base, regardless of whether or not they represent present industry standards or will at any time in the future conform with changing industry processing standards.

2. Under the proposed amendment, the static industry processing standards available to the salt industry are presumably contained in paragraph (c)(3)(C). As a preliminary to examining the provisions of this paragraph, it is important to remember that salt, insofar as depletion is concerned, is extracted by two methods—by means of dry rock salt mining, with the process being much like that of coal mining, and by brine well operations, or hydraulic mining, much as sulfur is extracted.

Directing your attention particularly to the hydraulic mining operations, it will be noted that this paragraph (C) provides under clause

(i) for crushing, grinding, sorting, screening, washing, and drying, to remove free moisture where applied to crude minerals or ores, and I emphasize that last phrase—"where applied to crude minerals or ores."

The immediate question is, of course, an obvious one. When salt brine is lifted to the surface is it then a mineral or an ore still in crude form? The answer seems equally obvious. It is not. Therefore, under the strictures of the Treasury Department amendment, that would be the end of depletion insofar as a vast segment of the salt industry is concerned, because brine would be no longer salt in crude form. This problem is even more sharply silhouetted by the fact that paragraph (4)(B) provides that "any treatment process which follows a process that is not considered as mining will not be considered as mining for the purpose of this subsection." Therefore, even though by some strange stretch of the imagination salt brine at the surface could be deemed to be a crude mineral or ore, there would be the intervening dissolving process of injecting water into a salt strata to produce the brine solution in the first instance, a process which is not included under paragraph (C), with the result being that by this test, as well as the crude mineral or ore test, the segment of the salt industry engaged in extracting salt by brine operations would have its depletable base cut off at the wellhead if not at the underground point where the salt enters solution.

3. This same line of contradiction is underscored by the fact that the brine, once it reaches the surface, can be turned into usable dry salt only by evaporation through the application of heat, either in vacuum pans or in so-called open grainer pans.

Again, the process of evaporation is not named as a process which will qualify under paragraph (C), so once more the "sudden death" limitation of paragraph (4)(B) takes over with the cutoff provision that "any treatment process which follows a process that is not considered as mining will not be considered as mining for the purpose of this subsection." So the Treasury giveth with its left hand and completely withdraweth with its right as to the hydraulic mining segment of the salt industry, which accounts for approximately 75 percent of total production. I include here in that percentage the salt that is produced in brine form but which is not used in brine form.

4. If there be any doubt about the fatal interplay as between the omissions of the dissolving and evaporating processes in paragraph (C) and the "sudden death" clause of paragraph (4)(B), then certainly paragraph (4)(A) makes it definitely clear that hydraulic salt mining receives depletion under the proposed amendment in name and not in fact. Paragraph (4)(A) specifically provides that mining processes shall not include either "refining" or "thermal action." By historical industry definition the whole process of transforming underground salt deposits into usable salt is deemed a refining process, and the key stage of that refining process for hydraulic operations is the application of heat, or thermal action, through the medium of a vacuum pan or the medium of an open grainer pan. Consequently, salt production by brining operations, by this test alone and regardless of all others, will be virtually deprived of depletion under the proposed amendment.

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5. Clause (ii) of paragraph (C) permits the inclusion of "beneficiation by concentration" as a mining process, but the meaning of this phase, by a subsequent sentence in the same paragraph, is limited to such processes as are applied "solely for the purpose of eliminating waste, or separating the mineral or ore from other minerals or ores, by gravity, flotation," et cetera. Clause (iii) permits "beneficiation by precipitation." Nowhere is provision made for the normal process in the brining phase of the salt industry for the elimination of impurities by settlement treatment, as contrasted to concentration or precipitation which are permitted processes.

6. Lumping two standard and necessary industry processes together in the salt industry, and these historically are common to both dry and hydraulic mining, it should be observed that, as a necessary result of the screening process—which is permitted under the proposed amendment—a blending of grades and the pulverizing of certain of those grades are thereafter highly essential. Nowhere in the proposed amendment is blending provided for. In fact, it might well be concluded that paragraph (4)(A), which prohibits the inclusion of "blending with other materials" might also prohibit the blending of grades. As for pulverization, "fine pulverization" is expressly prohibited by paragraph (4)(A), with no one knowing, which presumably should include the Treasury Department, to what extent pulverization can be pursued before it ceases to be "coarse pulverization," which is permitted only by innuendo, and becomes the prohibited "fine pulverization."

7. Adding to the confusion for the salt industry, if paragraph (4)(A) prohibits "blending with other materials" as just noted, then perhaps the very act of extracting salt by hydraulic mining is likewise specifically prohibited, because it consists of an underground blending of water with the salt strata to produce salt brine for the hydraulic lift. This is not a hypothetical question at all, because paragraph (c)(3)(B) specifically provides that sulphur can be recovered by hydraulic methods without losing its depletion status. The failure to accord a like specific treatment to the hydraulic phase of the salt industry leaves the latter somewhere in the left-field of depletion.

8. Perhaps the most amazing contradiction of all arises from a combination of clause (iv) of paragraph (3)(C), clause (v) of that same paragraph, the definitions of the words used in those two clauses, and the "sudden death" provisions of paragraph (4)(B). In essence the salt industry is first told that it may include in its depletable base the processes needed to bring salt to a "condition suitable for shipment" as well as the process of "loading for shipment." The definitive sentences then state that the processes for readying salt for a condition suitable for shipment must be simply those which make salt "capable of being transported as distinguished from those processes applied to make the mineral or ore salable." Immediately the salt producer must look over his shoulder to see the shadows of the Federal Food and Drug Administration and of the agencies in almost all of the 49 States which require registration and labeling of salt products used for human and animal consumption. As noted earlier, labeling irrevocably leads to packaging.

So, even though conceivably salt brine is suitable for transportation in a tank truck, a tank car or a pipeline, and assuming that dry rock

salt or any screen grade can likewise be transported in some vehicle without disappearing with the winds, the fact remains that, lacking a package, whole segments of salt production, be they initiated through dry mining or hydraulic mining, are not suitable for transportation for the use desired. In other words, notwithstanding the theories of the Treasury Department, salt is peculiarly a mineral the suitability of which for transportation is irrevocably controlled by its salability at the end of the transportation line. But with its definitive phrases, the Treasury Department imposes the impossible test of segregation as to suitability for transportation without a salability test.

To make this contradiction even more ironical, the definition portions of paragraph (C) then provide that the term "loading for shipment" shall not include the cost of packaging unless otherwise provided for in clause (iv), and then flatly prohibit the inclusion of the cost of package material, as contrasted to the cost of packaging, regardless of whether or not the cost of package material might otherwise be included in clause (iv). Therefore, even if the Treasury Department might concede that packaging is necessary to arrive at a stage of suitability for transportation, only that cost, but not the cost of the package material itself, could be included in the depletion base of the salt industry.

Adding further to the irony of the situation, the very act of employing package material might be construed as the interjection of a disallowed process under paragraph (4)(B), with the result being that the process of loading for shipment, which would otherwise be permitted under clause (v), would thereby be eliminated from the depletion base of the salt industry.

9. I now refer once more to the fact that paragraph (4)(A) prohibits the inclusion of "blending with other materials." Historically *additives have been needed for salt to preserve its usable* qualities, namely, free running, nondusting, noncaking, et cetera. To give to salt free running qualities which are disturbed or, in many cases, almost eliminated, without certain additives, and to avoid unendurable dusting situations in certain cases, the salt industry for years has injected certain additives in minute quantities.

Again, because of its attraction for moisture, salt in winter inventory stacks or piles will solidify to the point of requiring dynamite or equally abortive operations to make the salt inventory usable.

Additives in minute quantities in the form of sprays or otherwise have been employed to eliminate this problem. This undoubtedly is a blending with other materials as defined by the unrealistic provisions of the Treasury Department, and would offer the Department an opportunity for an early stage cutoff of the depletion base for salt. The fact that coal operators under paragraph (c)(3)(A) are specifically permitted dust allaying treatment and treatment to prevent freezing as a part of their depletion base would seem to make clear that a like intent is not harbored by the Treasury Department insofar as the salt industry is concerned.

From the vivisection process which is proposed amendment requires, certain conclusions clearly emerge. It seems to be the intent of the Treasury Department to place depletable industries in definitive and inflexible straitjackets, with the dimensions of those straitjackets being wholly unclear and contradictory, but with it being completely

certain that those dimensions vary radically from industry to industry. A long history of litigation has finally made relatively clear the terms and application of the present section 613, but I can only predict that the adoption of this contradictory and restrictive amendment will produce a field day for tax lawyers for years to come.

In the case of salt, the future of this litigation over the proposed amendment can be accurately forecasted. As I have attempted to describe in the analysis of that amendment, there is no way of determining without litigation whether or not the depletion base for the salt industry will be pushed back almost to zero at the underground stage, or cut off at the first heat application stage, or cut off at the first blending stage, or cut off at the packaging state. Only one thing seems certain, and that is the fact that the salt industry, by the very nature of its extraction and treatment processes, including the necessary process of packaging, will be in immediate trouble with the Treasury Department.

Finally, I cannot refrain from commenting on the reasons advanced by the Treasury Department for submitting the proposed amendment to this committee. Under date of January 26, 1959, the Secretary of the Treasury advised the Speaker of the House of Representatives, and I am sure the advice has reached the attention of this committee, as follows:

> It is now apparent under the court decisions that manufacturers of many other products may obtain depletion allowances based on gross income derived from the sale of finished products. This can only result in increasing the depletion deduction for all minerals severalfold—in extreme cases as much as 100 times. I do not believe that depletion on such an inflated scale is either reasonable or was intended. If permitted, the revenue losses will indeed be serious.

The essence of my comment on the foregoing quotation is simply this: In the opinion of the salt industry, the so-called revenue losses are not revenue losses in the true sense of those words. Depletion deductions have not been increased at all. Rather, the so-called revenue losses merely represented the difference between what the courts have said Congress, by statutory provisions, has granted to depletable industries, and what the Treasury Department, from its own viewpoint, believes industry should receive. This, in our opinion, is not a sufficient ground to inject chaos into the now understandable pattern of depletion and to penalize a whole host of industries, including the salt industry, in the process.

That concludes my formal remarks, Mr. Chairman.

The CHAIRMAN. Mr. Carey, we thank you for your discussion of the problems of the salt industry in this area.

Are there any questions of Mr. Carey? Mr. Boggs will inquire.

Mr. BOGGS. Were you in the room this morning when the Treasury people were testifying?

Mr. CAREY. Yes, I was, sir.

Mr. BOGGS. You heard Mr. Lindsay's statement?

Mr. CAREY. Yes, sir.

Mr. BOGGS. He made some specific reference to the salt industry, as you may recall. Would you care to comment on the reference he made?

Mr. CAREY. One reference I recall was that a case is now pending before the Court of Claims in which a taxpayer mining salt contends

that all processes applied to arrive at a refined salt packaged in various size containers are ordinary treatment processes.

Further down he refers to the fact that the deduction on salt in such a state would be around 100 times the deduction allowed on crude salt.

In the first place, dividing by 100, and knowing at least what our own market value is for salt in table salt containers, I think the value thus placed by innuendo on crude salt is extremely low. It must be crude salt in brine form in some chemical plant.

As far as the other matter is concerned, we are confronted by the fact that table salt is a food product, subject to the Food, Drug, and Cosmetic Act, and has to be labeled, and subject to libel and condemnation if it is contaminated.

The only way in which table salt can be shipped and sold is in a container.

Mr. BOGGS. What percentage of salt is mined for human and animal consumption as compared to industrial consumption?

Mr. CAREY. Referring to dry salt only, as distinguished from salt extracted and used entirely in the brine form and never reduced to dry salt, my recollection, without having specific information at hand, is that it is somewhere around 10 percent. That would be table and household use.

There would be a higher percentage if it would include all salt that would be used for food preparation. I do not have access to figures that would show that.

Mr. BOGGS. Would it be 20 percent then, 20 and 80?

Mr. CAREY. I think it could be as high as 20.

Mr. BOGGS. Twenty percent for food consumption in one form or another?

Mr. CAREY. Yes.

Mr. BOGGS. And the other for industrial purposes?

Mr. CAREY. Ultimately ending up in human consumption.

Mr. BOGGS. Which ultimately ends up in human consumption?

Mr. CAREY. Yes, sir. That would be my guess. I would have to have the record show it is merely a guess.

Mr. BOGGS. Twenty percent is for human consumption and food consumption generally; is that right?

Mr. CAREY. Yes.

Mr. BOGGS. Of the 80 percent, how much of that ultimately ends up in human consumption?

Mr. CAREY. Well, a greater deal of it is used industrially without ever being consumed, such as putting on highways, roads, and streets, for control of ice and snow, and for chemical uses.

Mr. BOGGS. I do not think you quite understood my first question. When you say 10 percent, did you mean just table salt?

Mr. CAREY. The 10 percent I referred to referred only to table salt, or salt used in the households.

Mr. BOGGS. What I am trying to find out is how much of it is consumed as a food product and how much of it is used for these other purposes that you mentioned, such as sprinkling on roads, and so forth?

Mr. CAREY. I would estimate that 15 percent of the salt tonnage is used for human consumption, either in table salt form or going into

canning or meat preparation or food preparation, baking, flour, and the like, and the other 80 to 85 percent would be miscellaneous uses not involving either table or human consumption purposes.

Mr. BOGGS. So that your labeling problem does not spread across the board?

Mr. CAREY. It does not spread across the board, the whole board, insofar as all of that salt is concerned. A certain amount of the other tonnage is used in the livestock industry, for feeding livestock. Of course, a lot of that is labeled.

Mr. BOGGS. I wanted to include that in the first figure we used, animal consumption. Where are the principal sources for salt production in the United States?

Mr. CAREY. The principal sources of salt production in this country are, working from east to west, New York, Ohio, Michigan, Louisiana, Texas, Kansas, Utah, and California.

The CHAIRMAN. Pardon me for interjecting, but you left out the State that had more to do, perhaps, with the inclusion of salt for depletion allowance than any State, and that was Alabama. Did you know they produced salt in Alabama?

Mr. CAREY. Alabama produces salt in brine form, I believe, Mr. Chairman. I believe a chemical plant there uses it in brine form, but it is not used in dry form.

The CHAIRMAN. Certain representation from that State had a lot to do with this. Do not leave Alabama out.

Mr. BOGGS. I have nothing further, Mr. Chairman.

Mr. CAREY. Mr. Chairman, if I might, also referring to the testimony of Mr. Lindsay this morning, and to some of the questioning, I would like to describe the situation or the status of our industry at the present time as regards the present circumstance.

Mr. BOGGS. I elicited from Mr. Lindsay the information that they had never agreed on a formula with the salt industry so far as the application of this percetnage depletion is concerned. He said that, if I remember correctly.

Mr. CAREY. That is correct.

Several years ago, around 3 years ago, a committee from our industry approached the Treasury Department offering a compromise or a basis between the various ways in which the various revenue districts had sought to audit the income tax returns of salt companies, and offered, as I say, a compromise.

They were not successful in getting an answer, actually, or in getting together for a serious meeting on the subject, and gave up. Subsequently, various companies, including my own, have filed their cases in the Court of Claims or in the district court or in the Tax Court.

However, the Department of Justice, the Trial Division of the Department of Justice, has two of these cases before it now which are in the Court of Claims, and those cases and those parties are getting attention and consideration, we feel, and we also feel that it is very likely that there will be an outcome which might well be satisfactory to both the Government and the taxpayers. We feel that we will be better off by leaving the present law as it stands, having spent so long in the process of getting it adjudicated.

The CHAIRMAN. Mr. Byrnes will inquire.

Mr. BYRNES. I take it that it is your position that you should have depletion allowance in the case of salt on your entire gross income. Is that right?

Mr. CAREY. I might at this point mention the compromises that were proposed.

Mr. BYRNES. I am trying to get what your point is here as far as your testimony is concerned. Do you feel that your entire operation, your entire gross income, is eligible for percentage depletion? I suppose you leave out of it the cost of sales. Is there any process that you consider part of the manufacturing process as distinguished from the mining process?

Mr. CAREY. Well, I would propose that we impute to certain containers, which are very small, and obviously more package than salt, a sales value of larger, more popular——

Mr. BYRNES. Your statement said that packaging was part of it. I got the inference that even preparing special labels, because the Food and Drug Act requires it, that that cost was not a cost of manufacturing but a cost of mining.

Mr. CAREY. We feel that we have a very unique situation on our hands.

Mr. BYRNES. So does everybody who manufactures things, a person who makes chemicals, a person who manufactures drugs, who come under the Food and Drug Act. But in order to comply with it, it is not a mining process but a manufacturing process. Is that not correct? All I suggest is that I think holding to an attitude, such as the atitude I gather from your statement, that the entire process right up to putting it in the train or in the truck and shipping it to the retail stores would be part of mining and, therefore, subject to the 10 percent depletion, that attitude is the best way in the world to get the 10 percent eliminated from any part of the process.

That is all, Mr. Chairman.

The CHAIRMAN. Is there anything else?

Mr. MCBRIDE. Could I add one comment to Mr. Byrnes' inquiry?

The CHAIRMAN. Yes.

Mr. MCBRIDE. I was a member of the legal committee representing the industry before the Tax Ruling Division of the Treasury Department. In an effort to get at the very problem that you have raised, the considerations we suggested to the Treasury Department, that Mr. Carey just alluded to, consisted of four areas. We started out with the net sales basis, and attempted to work out a rollback basis, if that is a proper term for it.

We suggested that there be eliminated from the basis the cost of compression. Salt is put up in 50-pound blocks, for farm use, for example; it is put up in pellets for water softening. We were authorized by the industry for the Tax Ruling Division to eliminate that compression operation from the depletion base.

The second item that we offered to eliminate from the depletion base was the additives that have been put into salt, at least by some companies, for food fortification. I am distinguishing those from additives that are put in for free-running qualities or dust-repellent qualities. Iodine, for example, for human consumption, and min-

erals for animal consumption. We offered to eliminate those additives and the cost of mixing those additives.

The third area we offered to eliminate from our depletion base was the cost of packaging material for all packages other than where we were required to package for the Pure Food and Drug and by any registration requirements of the 49 States.

So we were asking only to keep in the cost of packaging material where required by other Federal or State laws, and to eliminate the other package material from the depletion base.

The fourth area that we offered to attempt to eliminate from the depletion base was the fact that whereas the 26-ounce package, which is the standard product for household use, there are some smaller packages, 4 ounces and miniatures, so-called Mr. Carey alluded to those as having a high ratio of package cost in them. There, again, that is for human consumption so it has to be packaged, but we offered to translate into the 26-ounce standard product for household consumption the tonnage that went into the packages smaller than 26 ounces, so as to eliminate that high factor of package material.

That lay in the Tax Ruling Division, I think, for close to 2½ years, with no results. It was a subject of a lot of conferences and no decisions reached.

We finally filed in the Court of Claims, the Carey Salt Co. did. We represent Morton Salt Co.

On the very first conference, that same compromise arrangement for the depletion base was offered to the Tax Trial Division of the Department of Justice and it is now being considered.

Well, I probably should not be using adjectives like "seriously." But certainly there have been at least five sessions with Justice in an effort to work out some sort of a standard practice that the salt industry might live under. I only want to cure one impression, that for 3 years the industry has not been adamant on a net sales basis. We have been trying to work out something that will include us in with a proper depletion basis and at the same time give recognition to the fact that we are the only consuming food mineral in this whole list and we have to live with Pure Food and Drug as well.

Mr. BYRNES. The only point I care to make, Mr. Chairman, is that I think anybody who comes in here and insists that the cost of packaging material is included as a part of the mining process is presenting the kind of situation that gives rise to some of the public sentiment that we hear voices today that this whole percentage depletion thing is a racket, and a great big loophole. I think when we insist on going to those kinds of extremes in the application of percentage depletion, we just invite a further and greater feeling along that line, which I think can lead to only one thing. That is the potential elimination of the whole depletion allowance to any process. The public will revolt against the allowance of any depletion allowances.

That is all.

The CHAIRMAN. Are there any further questions? Mr. Alger will inquire.

Mr. ALGER. Mr. Carey, your criticism was directed almost entirely against the Treasury recommendations. Are you satisfied with the present law?

Mr. CAREY. We feel that the present law has a great deal more flexibility to it, because it does not purport to be completely a definite law in all respects. Referring to certain language which we feel——

Mr. ALGER. I do not mean to go into the entire field of the present law. You are saying that of the two, then, you are more satisfied with the present law?

Mr. CAREY. We are more satisfied, mainly directing it to the fact that the definition of mining under the present law includes "the ordinary treatment processes normally applied by mine owners or operators in order to obtain," and so on.

The word "normally" includes processes used now or which may be used from time to time in the future as technique is improved and better processes are developed, rather than having to amend or rewrite or redefine from time to time a law which purports to be purely specific.

Mr. ALGER. Do you see any merit in the Treasury's concern over this entire field about the first commercially marketable product? Do you see merit in their concern, in the difficulty of definition?

Mr. CAREY. Well, I believe that the Treasury's concern, of course, is to get in all the tax money that they possibly can. I think it is a question of the intent of Congress at the time the law was passed, and whether they are saying that the courts are construing the act contrary to the original intent of Congress, or they are saying that the intent should be changed because of the way it has worked out. I believe that is up to Congress, of course, to determine.

Mr. ALGER. Do you think that the salt business is unique, then, beyond all other products, for example, as a consuming product? That is the impression I am getting. Would you say that your product, a mineral or whatever it is, is different from all others?

Mr. CAREY. Well, it is unique in a number of respects. It is produced in the two or three ways which I mentioned. Salt produced in one way is not as suitable for certain purposes as salt produced in, let us say, an evaporated process.

Mr. ALGER. Well, maybe salt is in a class all by itself, and no matter what the law is it will have to be specially treated with a special law applicable to salt, if all of this is so.

Mr. CAREY. That is possible. We feel that a great deal of progress has been made in our own conferences with the Department of Justice. We feel that no matter how this law is written, there is going to be a lot of work in the courts on it, and we will have lost the progress that has been made in the past number of years toward defining just what, according to the courts, the law means with regard to salt.

Mr. ALGER. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. We thank you, Mr. Carey, and those with you, for your statements.

Mr. CAREY. I thank your committee very much.

The CHAIRMAN. The next witness is Mr. Krause, representing the National Crushed Stone Association.

STATEMENT OF H. C. KRAUSE, CHAIRMAN OF THE PERCENTAGE DEPLETION COMMITTEE OF THE NATIONAL CRUSHED STONE ASSOCIATION, ACCOMPANIED BY JOHN F. LANE, COUNSEL, NATIONAL CRUSHED STONE ASSOCIATION

Mr. KRAUSE. Mr. Chairman, I have brought John Lane, who is counsel for the National Crushed Stone Association, to sit with me.

The CHAIRMAN. Very well. You may proceed.

Mr. KRAUSE. My name is H. C. Krause. I am the president of the Columbia Quarry Co., St. Louis, Mo. I am also chairman of the percentage depletion committee of the National Crushed Stone Association, on whose behalf I am privileged to appear before your committee today.

The National Crushed Stone Association—sometimes referred to as NCSA—is a nonprofit trade association whose members engage in the quarrying of rock and the production of crushed-stone products in all sections of the United States. The substantial importance of the economic well-being of our industry to the Nation's economy is indicated by the fact that in 1957 it produced 536,443,000 tons of crushed stone and that virtually all roads, bridges, airports, and commercial construction of all types includes the use of crushed stone—aggregates. Additionally, the steel, lead, glass, paint, carbide, paper, and numerous other industries require our products to produce their own.

I. THE POSITION OF THE NATIONAL CRUSHED STONE ASSOCIATION ON THE TREASURY BILL

In its application to crushed-stone producers, we oppose the Treasury bill in its present form and propose an amendment to it to solve our complex and longstanding problem as to the basis of, or cutoff from, our percentage depletion allowance computation.

We oppose the Treasury bill in its present form and urge its amendment because:

(*a*) The Treasury bill not only fails to resolve difficult and complex cutoff problems in the application of percentage depletion to crushed stone experienced during the last 8 years, but it would enlarge existing problem areas and, in addition, would create entirely new uncertainties and confusion;

(*b*) The terms of the Treasury bill are uncertain and ambiguous in their application to crushed-stone taxpayers and, particularly when interpreted by restrictive Treasury standards, may result in drastic and unjustified reductions in the percentage depletion allowances of crushed-stone producers;

(*c*) The Treasury bill overlooks or ignores a basic, and here controlling, fact of our industry; namely, that we engage in but one process. That single process may be aptly described as "making little ones out of big ones," for our single process involves only the successive reduction in the size of rock as it exists in nature. We deliver natural rock to customers unchanged from its natural state except that we have reduced the size of its constituent pieces or particles from the size of a mountain to various sizes on down to the finest dust; and

(*d*) Recognizing that ours is but a one-process industry inevitably forces the conclusion that since we are entitled to percentage deple-

tion as being plainly engaged in mining a natural resource, we should be allowed depletion on our entire—single—mining process of size reduction of the rock. We should not be required to make unrealistic and impossible distinctions between kinds or types of size reduction processes such as between crushing, grinding, pulverization, and fine pulverization, as the Treasury bill requires.

We therefore suggest an amendment to the Treasury bill—modeled upon the Treasury's own proposal for coal, whose processes parallel ours—which would make this principle unchallengeable by anyone.

II. AMBIGUITIES IN BILL'S APPLICATION TO CRUSHED-STONE PRODUCERS

Crushed-stone producers were first accorded percentage depletion in the 1951 Revenue Act. Although the present statute has now been in force as to crushed stone for almost 8 years, the Treasury Department has yet to lay down definite rules stating its position as to the depletable processes of crushed stone. At the same time, the field offices of the Internal Revenue Service apply different and inconsistent interpretations of the statute in determining what are the ordinary treatment processes of crushed stone. And Government attorneys in conferences and litigations take varying and often inconsistent positions.

The failure of the present statute and of Treasury interpretations to clearly and specifically set forth the "ordinary treatment processes normally applied" to crushed stone leads not only to inconsistent and often discriminative treatment as between different crushed stone producers, but also to extended administrative reviews and court litigation which is both bothersome and expense to small crushed stone producers.

It was only very recently two district courts have rendered decisions in two important cases—namely the Centropolis Crusher Co., and California Portland Cement cases—in which it has been held for the first time that all of the processes applied to crushed stone which are normally applied by crushed stone producers to obtain the commercially marketable product or products are allowable ordinary treatment processes. There are no court decisions to the contrary. But the proposed bill would change the present case law.

We very respectfully submit our protest that the proposed bill will perpetuate and enlarge this totally unjust situation. In its application to us, the bill will not, as the Secretary stated in his letter to the Speaker of January 26, "help resolve difficult and complex problems" in this area. We think the reverse is true. This is made plain by disclosing some of the bill's ambiguities and uncertainties as applied to our industry.

(*a*) In listing as "mining" the treatment processes of crushing, grinding, sorting, screening, washing and drying, the Treasury bill in reality permits depletion as to such processes only "where applied to crude minerals or ores." However, the term "crude minerals or ores" is not defined in the Treasury bill. We do know, though, that the Treasury's proposed—but as yet unissued—regulations under the 1954 act would define "crude mineral product" to mean a mineral in the form in which it emerges from the mine. But we do not yet know what that definition would mean in its application to our industry.

For example, the Treasury has only recently proposed new definitions for four stone terms appearing in the percentage depletion provision of the 1939 code. These proposals radically change prior definitions aggressively enforced for years.

In any event, based on past experience in the field of percentage depletion, it would appear that it may be many years before a satisfactory definition of the "crude mineral" term is finally determined if left to Treasury regulations. Failure to define this term in the Treasury bill would no doubt lead to many difficulties for stone producers.

Thus, assuming natural rock or stone deposits to be a "mineral," the question immediately arises as to whether stone which has been blasted from the quarry face is any longer a crude mineral and, if it is, when does it cease to be such? Furthermore, if stone is not a crude mineral after blasting or any other stage of processing, all subsequent processes of crushing, grinding, sorting, screening, washing and drying, even though specified in the bill, could well be held by the Treasury to constitute nonmining processes and hence not depletable because the processes were not applied to a "crude mineral."

In short, for lack of assurance otherwise in the bill, we must view this provision as a threat to virtually the entire percentage depletion deduction of our industry.

(*b*) The Treasury bill contains no definition of the terms "crushing," "grinding," or other specifically enumerated mining processes. Nor does it contain any provision which would require all of the enumerated processes to be classified as mining processes. This failure of the bill to define or include all the enumerated mining processes is particularly troublesome when we come to distinguish between "crushing" and "grinding" on the one hand and "pulverization" and "fine pulverization" on the other hand. For "fine pulverization"—whatever it may be—is expressly classified by the bill as a nonmining process. And "pulverization"—whatever it may be—it expressly classified as a "mining" process of talc.

Yet it is obvious from dictionary definitions and the "common understanding" of the terms "crushing," "grinding," "pulverization," and "fine pulverization" that these terms overlap or are synonymous. "Crushing" is "grinding" and "grinding" is "pulverization." They are all size reductions. As I suggested at the outset, in our industry there is but one essential process—size reduction. Obviously, therefore, the Treasury bill is also ambiguous on its face in this respect. And the simplest solution of our problem is to make unmistably clear that all of our size-reduction process is depletable.

(*c*) In addition to the specific processes enumerated in the bill and referred to above, the bill allows—(3) (C) (iv)—as mining processes "any additional processes" and "loading for shipment." However, the bill expressly provides that any such "additional process" or "cost of packaging" shall not be allowed as a mining process unless necessary to bring the mineral or ore to the physical form and condition in which it is capable of being transported as distinguished from those processes applied to make the mineral or ore salable. The effect of these provisions in the case of crushed stone would seem to be to disallow as depletable "mining" processes all processes other than the crushing, grinding, sorting, screening, washing, drying, and loading processes specifically provided for in the bill.

This seems to mean that once rock is capable of being transported, and whether it is then salable or not, further processes are not depletable. For the Treasury could take the position that any additional processes are not necessary in order to put crushed stone into a form where it is capable of being transported, on the grounds, for example, that stone is capable of transportation after blasting or primary crushing or grinding.

Further, it seems clear from the bill that if any of the crushing, grinding, or other processes specifically mentioned in the bill are not allowable as "mining" processes for the reasons hereinbefore set forth that they would certainly not be allowable as an "additional process." For it is further expressly provided that any process which follows a nonmining process may not be considered to be "mining."

(*d*) We also think unwarranted as to us the provision in the Treasury bill which would treat as a nonmining process any process following a process that is not considered as mining. As previously mentioned, the bill would treat "fine pulverization" as a nonmining process. On the other hand "loading for shipment" would generally be allowed as a mining process. However, under the Treasury bill it appears that "loading for shipment" would not be a "mining" process when it follows the nonmining process of "fine pulverization." On the other hand, loading for shipment might be a "mining" process where no fine pulverization takes place. Thus we have the unusual situation of treating loading costs as a "mining" process in the case of some producers and as a "nonmining process" as to others. This would mean that there will be discrimination against certain producers. Since loading for shipment is generally considered to be a mining process it would appear that it should be treated as such in the case of all crushed stone producers. Such would be the case if all our processes were considered "mining."

(*e*) As previously mentioned, the Treasury bill would treat as a nonmining process "fine pulverization" which is not defined in the statute. Since this term is synonymous with and not distinguishable from the terms "crushing" and "grinding," it is impossible on the face of the bill to determine where "crushing" and "grinding" end and "pulverization" and "fine pulverization" begin.

These purported, but totally unrealistic, distinctions lend further support to our position that the processing of crushed stone is of such a nature that there is, in effect, but a single continuous process in crushed stone production—size reduction—and that our single size reduction process should be considered as "mining" in its entirety.

(*f*) A further ambiguity arises when the bill is considered in the context of the present—and not to be changed—provision of section 613(b)6. There Congress accorded specific rates of depletion to—not minerals or other natural deposits—but to particular rock products which are expressly named. Thus "road material," "concrete aggregates," "ballast," et cetera, are rock products. They are not types of natural deposits. They have a 5 percent rate of depletion regardless of the degree of fineness to which any portion of them may be broken.

Yet specifications governing these products require much fine material. But nowhere has it been suggested—unless this bill does—

that these products may have depletion on that portion which exceeds an unspecified degree of coarseness and no depletion on that portion below such point. The lack of realism and practicality in any such approach is hence again apparent. And the plain answer is not to attempt impossible distinctions in our size reduction processes.

III. ROCK CRUSHING IS ONE PROCESS—SIZE REDUCTION

In view of the foregoing ambiguities in the Treasury bill as applied to our industry, it is our considered opinion that if this committee is to recommend new legislation on this subject the only satisfactory solution of the problem is to amend the Treasury bill to:

1. Include in the bill particular and special provisions as to crushed stone—as the Treasury has done in the case of coal, sulfur and talc—which will clearly, fully and expressly recognize our industry as essentially a single process industry and to make clear that all processing of crushed stone is "mining." This, we submit, would be accomplished more simply by providing expressly:

2. That the processing of crushed stone classified as "mining" shall include stripping, drilling, blasting, breaking, cleaning, washing, drying, crushing, grinding, pulverization—including fine pulverization—elevating, sizing, screening, sorting, storing, recombining, weighing, bagging and packaging and loading for shipment.

Our industry has no market and no salable value for stone as it is blasted from the quarry, except for the relatively small amount which may be sold as "riprap"—that is, very large blocks for levees, et cetera. In order to market rock—the natural deposit—it must be processed by reducing its size to meet the demands of various customers for various sizes of crushed stone.

The extent to which rock is processed by a producer is determined largely by the demands of his customers. Because of the relatively high cost of transportation compared to the cost of the stone an operator's market is usually limited to a restricted market area. For this reason a producer cannot generally finely grind all his products and market it throughout the United States. Rather, he must crush it to various sizes to meet the demand for various sizes of stone in a limited market area.

The use to which stone is to be put is another factor bearing on the extent of the required processing. The use of a stone is in turn determined by many factors including its quality and properties such as chemical composition, toughness, porosity, specific gravity, and resistance to weathering.

For example, a soft stone not suitable for road use but a high chemical quality may be finely ground or pulverized for chemical use. On the other hand, stone not suitable for chemical or metallurgical use may be sold in larger sizes for road use or other such uses.

For construction or road uses, for example, State and governmental specifications set forth varying size requirements. Construction aggregates may be required to include as many as 10 or more different sizes of stone in specified proportions ranging from 12-inch to 200-mesh size. And even stone for road use must be finely ground or pulverized to substantial extent—as much as 30 percent.

However, a producer cannot possibly process all his stone to exactly meet his customers' requirements. This is due to the fundamental, but little recognized, fact that the producer cannot possibly control the extent of the size reduction in crushing and grinding processes. The stone producer can no more control the size reduction of his stone than we can control the size of fragments when a light bulb is hurled to the ground.

To llustrate, metallurgical limestone is used as a flux in blast furnaces, usually in relatively larger sizes ranging from approximately 18 inches to 2 inches. In order to produce a thousand tons of fluxing material of such sizes, a producer would have to blast out of his quarry approximately 2,000 tons of stone. The blasting and crushing processes necessary to reduce the stone to the desired fluxing size, therefore, would result in 1,000 tons of fluxing stone and 1,000 tons of stone in smaller sizes. This is because the crushing process cannot be precisely controlled and some of the stone is inevitably crushed to smaller or finer sizes than may be desired.

As mentioned, the fundamental character of the crushed stone industry's operations are to effect successive and often continuous reductions in the size of the rock or stone. In this process of size reduction, we have also seen, stone does not break into equal or uniform sizes when broken or fractured. This is a physical factor uncontrollable by the producer. Therefore, at each successive stage of breaking some "fines" are produced. These so-called fines may consist of fillers, dusts, powders, or granulated particles which may or may not be needed to meet customer demand. Sometimes these fines may be difficult to market.

At various stages of processing the stone is screened to separate it into various uniform sizes. But the screening is obviously only a part of our size reduction process. Larger sizes of stone may then have to be recrushed to obtain the sizes demanded by the operator's customers within his limited market area. Since the nonuniform breaking of stone is beyond the control of the producer some sizes may accumulate and have to be stored. In addition, various sizes of stone may have to be recombined in specific proportions to meet the exact requirements for such uses as road aggregates or concrete aggregates. In all respects, therefore, the processing of rock to crushed stone is a continuous process of a reduction in the size of the rock to achieve the ultimate product.

This successive size reduction process has but one primary purpose. That is to meet insofar as possible the demands of various customers for crushed stone—whether such demands are for large sizes or small sizes of stone. For this reason, it is wholly impractical and unrealistic to try to separate the processing of crushed stone into separate categories of different sizes, i.e., "grinding," "pulverization" or "fine pulverization" as being "mining" or "nonmining" processes.

The size reduction process of breaking rock—like coal and talc—is applied to put the rock in the size appropriate for its sale. Rock is the product quarried and crushed rock is the product sold. There has been no extraction of a mineral from ore. Nothing is added or subtracted except dirt is subtracted. The product sold is the rock as it existed in nature except that its particles have been reduced in size.

IV. NCSA AMENDMENT OF TREASURY BILL

The realities of our industry, as herein outlined, when fairly evaluated dictate a ready solution. The percentage depletion problems of crushed stone producers cannot be solved by attempts to generally equate the depletable treatment processes of other industries to our basically one-process industry. This is the core of our past and present difficulties.

The simple and entirely justifiable solution is to make the proposed statute clear that all of our treatment processes are depletable. This solution, though simple, is not, we believe, incompatible with the Treasury's primary reason for presenting its bill. It lies simply in this basic principle:

Since all crushed rock products consist of rock which is unchanged from the rock in its natural deposit in the earth except for the reduction in size of its constituent pieces or particles, all of the processes by which crushed rock products are produced should be considered "mining" and depletable.

To reflect this principle in the proposed legislation so as to place it beyond possibility of successful challenge, we urgently recommend that the Treasury bill be amended by adding to the bill a new provision following subparagraph (A) of paragraph (b)(3) as follows:

In the case of crushed stone—all processes including stripping, drilling, blasting, breaking, cleaning, washing, drying, crushing, grinding, pulverization—including fine pulverization—elevating, sizing, screening, sorting, storing, recombining, weighing, bagging, and packaging and loading for shipment.

We deeply appreciate your careful consideration of our problems. Thank you very much.

The CHAIRMAN. Thank you, Mr. Krause, for bringing your views to the committee.

Are there any questions?

Mr. CURTIS. Mr. Chairman.

The CHAIRMAN. Mr. Curtis of Missouri is recognized.

Mr. CURTIS. Mr. Chairman, I have received a communication from Mr. V. R. Koenig, of the Mississippi Lime Co., which I ask be placed in the record at this point.

The CHAIRMAN. Without objection, it is so ordered.

(The material referred to is as follows:)

MISSISSIPPI LIME CO.,
Ste. Genevieve, Mo.

Congressman THOMAS B. CURTIS,
Washington, D.C.

DEAR MR. CURTIS: Mississippi Lime Co., a Missouri corporation, is a producer of high calcium chemical limestone and lime products, with principal mines located at Ste. Genevieve, Mo., with approximately 850 employees.

A bill has been introduced regarding percentage depletion on which hearings are to be held by the House Ways and Means Committee, which, we believe, merits the careful consideration of yourself as well as all other members of that committee.

With respect to limestone and lime, in which we are particularly interested, the proposed changes cover principally:

(1) The designation of chemical and metallurgical limestone as that which has at least a 95-percent calcium carbonate content.

(2) The limitation of the percentage depletion base to the product at the completion of the mining stage rather than to the finished product (in the case of mining operators who calcine limestone into quicklime, hydrate lime, and other products).

The proposed changes fail to define what constitutes "gross income from mining" or the method to be employed in determining such gross income.

We have no particular objection to (1) use of a 95-percent requirement, since our limestone qualifies in that respect.

With respect to (2), the computation of percentage depletion on the basis of gross income from the product at the completion of the mining stage rather than a subsequent finished product, we are willing to accept whatever is finally agreed upon by the committee as the basic premise on which percentage depletion computations are to be based for all types of depletable minerals and ores.

We seriously object, however, to the failure to define what constitutes "gross income from mining" or the method to be employed in determining such gross income.

The present law states that percentage-depletion deductions shall be based on gross income from the property. This has been permitted with respect to oil and gas for a great many years and is satisfactory for oil and gas depletion as it clearly contemplates the proceeds received for the gas and oil as well as for the processes required to bring it to its first marketable stage.

With respect to mines, the present law states that the gross income from the property shall be the gross income from mining. However, there is no definition in the proposed law or in the proposed revisions as to what constitutes gross income from mining or how to determine it. There is a definition of mining in the present law which spells out certain ordinary treatment processes and a catchall phrase which permits the inclusion therein of all processes necessary to bring the mineral to a commercially marketable mineral product or products. By implication, at least, this authorizes percentage depletion deductions based on proceeds received for the mineral itself as well as for the indicated mining processes.

The proposed changes in the law eliminate any reference to commercially marketable mineral product or products but spell out certain specific processes which qualify as mining processes. This leaves the question up in the air as to whether gross income from mining includes proceeds received for the mineral (the depleting asset) itself or whether it is limited to proceeds received purely for the specified mining processes.

We do not feel that any proposed changes in the percentage depletion law should be passed unless it includes a definition of "gross income from mining" somewhat along the following lines:

Gross income from mining should be based on realized or published prices for the product at the completion of the mining stage, since such prices will cover not only gross income from the mining processes but also gross income from the mineral content included in the mined product.

Mississippi Lime Co. sells approximately 20 percent of its mined limestone as stone, with the remaining 80 percent being processed into and sold as quicklime, hydrate, lime, and so forth. Based on these facts one would assume that the Internal Revenue Service should agree that our gross income from mining should be based on the average per ton price realized from substantial bona fide stone sales as applied to all mined tons. But they have refused to do so. Instead they insist that in our case the proceeds received for lime, etc., should be allocated as between gross income from mining and gross income from other processes on the basis of costs of each. This throws a substantial part of proceeds received for mineral content into gross income from other processes on which percentage depletion is denied. Allocation additionally assumes that the same profit must be realized on the denied processes as on mining. This penalizes the efficient mine as against the inefficient and is purely an arbitrary assumption.

A typical example of the foregoing is as follows:

	Direct plant costs	Realized proceeds
2 tons limestone	$2 mining	$6
1 ton lime made from 2 tons of stone	$2 mining $8 calcining	15

The Internal Revenue Service contends that while percentage depletion is allowable on $6 for the two tons of limestone sold as limestone for that amount it is only allowable on $3 (two-tenths of $15) for the two tons of limestone used

to make one ton of lime. This is obviously in error, but the Internal Revenue Service insists that under present law they are given the option of using either the realized price method or the allocation of profits method, and they will allow only the lower of the two amounts arrived at thereby. It seems to us that it would be much more equitable to give the taxpayer the option of methods, if optional methods are to be authorized.

The Internal Revenue Service has been given too much latitude in determining "gross income from mining" and can be expected to rule harshly against taxpayers on one pretext or another unless the law or committee reports clearly define what is meant by such term.

The officers of Mississippi Lime Co. do not request any unusual or unfair advantage for itself or its products. It does feel, however, that all taxpayers in the same line of business should be treated the same by a clear-cut definition of what Congress intended and not be subjected to variable whims and interpretations by the numerous representatives of the Internal Revenue Service.

Very truly yours,

MISSISSIPPI LIME CO.,
V. R. KOENIG,
Vice President-Treasurer.

P.S.—I wish to take this opportunity for thanking you for the opportunity of briefly discussing the subject covered by this letter during my recent trip to Washington.

V. R. K.

The CHAIRMAN. The calendar has been concluded for the day. The committee will recess until 10 a.m. tomorrow morning.

(The following material was received by the committee:)

IOWA LIMESTONE CO.,
Des Moines, Iowa, March 3, 1959.

Subject: Proposed legislation on percentage depletion.

Hon. WILBUR W. MILLS,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D. C.

DEAR MR. MILLS: Iowa Limestone Co. mines a limestone deposit located near Alden, Iowa. We produce finely pulverized limestone for mixture with cattle feed; consequently, our product must meet the most rigid specifications regarding purity and calcium carbonate content. We would be adversely affected by enactment of certain proposed income tax legislation and wish to express our views regarding same.

The U.S. Treasury Department has recently proposed amendments to section 613 of the 1954 Internal Revenue Code. This section, of course, deals with the definition of gross income from the property, against which is applied the percentage allowable for any given mineral to determine the percentage depletion deduction allowable for income tax purposes. The term "gross income from the property" includes not only extraction of the mineral from the ground, but also the ordinary treatment processes normally applied by the mine owner to obtain the commercially marketable mineral product. The Treasury bill now proposed would severely restrict the definition of "ordinary treatment processes," with resultant harsh restrictions on the determination of gross income from the property and, in turn, the deduction allowable for depletion of natural resources.

Historically, percentage depletion for limestone and numerous other minerals was first allowed in 1951. While for some developers of natural resources this resulted in an increased deduction for income tax purposes, for many others it resulted in substantial decreases in the depletion deduction because at the same time percentage depletion was allowed on a particular mineral, discovery depletion was disallowed on that same mineral. In 1954 the allowance of any discovery depletion was removed entirely.

It has been stated that the reasons for allowing a deduction for depletion in the income tax law are to provide for the return of invested capital and provide incentive for the development of natural resources. Since the return of invested capital could be provided by cost depletion, it appears that the incentive was to be provided by first discovery depletion and then by percentage depletion. Discovery depletion, for all practical purposes, was discontinued in 1951. The Treasury Department's proposed legislation is an attempt to curtail percentage

depletion. The general trend, then, appears to be removal of the incentive to developers of natural resources. We believe this country continues to need incentive in order to attract risk capital to invest in the development of natural resources.

From a practical point of view, the Treasury bill provides, in effect, that there be a cutoff point at a certain stage of production for each of the various minerals. Just how gross income from the property will be determined at this cutoff point is not explained in the proposed legislation. There would not, of course, be any selling price at the cutoff point. It can only be presumed, therefore, that the regulations to be promulgated under any new section 613 must explain such things as the proper allocation of overhead, for example, administrative expenses, allocation of the ultimate profit; that is, the difference between selling prices and total cost of operations, between those stages of production occurring before the cutoff and those occurring after the cutoff. It is our sincere belief that enactment of the Treasury Department's proposed legislation and the promulgation of regulations thereunder will breed far more uncertainty, confusion, and litigation than has the present section 613, which is only just now becoming somewhat understood and stabilized under various court decisions.

We are a member of the National Crushed Stone Association, which organization has comprehensive knowledge of the problems in our field and whose representatives will appear before the Ways and Means Committee to testify in connection with the proposed legislation on percentage depletion. For the above-outlined reasons, we urge you to give favorable consideration to the views expressed by representatives of the National Crushed Stone Association.

Sincerely yours,

IOWA LIMESTONE CO.,
WALTER W. WILSON,
Chairman of the Board of Directors.

DES MOINES, IOWA, *March 4, 1959.*

Hon. WILBUR D. MILLS,
Chairman, Ways and Means Committee,
House of Representatives, Washington, D.C.:

The Iowa Limestone Producers Association, Inc., wish to inform your committee that we wholeheartedly support the position being taken by the National Crushed Stone Association, opposing the U.S. Treasury bill pertaining to percentage depletion. We endorsed the amendments as presented before your committee by the National Crushed Stone Association.

THE IOWA LIMESTONE PRODUCERS ASSOCIATION, INC.,
ROBERT E. FRAMPTON, *President*

SALISBURY, N.C., *March 6, 1959.*

CHIEF COUNSEL,
Committee on Ways and Means,
New House Office Building, Washington, D.C.:

With reference to meeting next Monday morning, we wish to protest change in depletion on mining and manufacturing lightweight aggregate which is in competition with sand, gravel, and natural aggregates. The change will be detrimental to our industry, and we hope for a favorable consideration on present basis.

CAROLINA TUFF-LITE CORP.

THE GENERAL CRUSHED STONE CO.,
EASTON, PA., *March 3, 1959.*

Subject: Proposed Treasury percentage depletion bill.

Hon. WILBUR D. MILLS,
Committee on Ways and Means,
U.S. House of Representatives, Washington, D.C.

SIR: We oppose the Treasury bill in its application to crushed-stone producers as establishing principles in the law of percentage depletion which would operate to the serious disadvantage of crushed-stone producers.

In order to be constructive in our opposition, we proposed the following amendment to the Treasury bill, which would insure that a percentage depletion allowance would be accorded to all ordinary processing of crushed stone producers; namely, stripping, drilling, blasting, breaking, cleaning, washing, drying, crushing, grinding, pulverizing (including fine pulverizing), sizing, screenings, sorting, storage, recombining, weighing, bagging and packaging, and loading for shipment.

Your support in having the foregoing amendment incorporated in the Treasury bill will be greatly appreciated.

Very truly yours,

THE GENERAL CRUSHED STONE CO.,
O. E. BENSON, *President.*

AMERICAN GILSONITE CO.,
Salt Lake City, Utah, March 3, 1959.

Re proposed legislation relating to depletion allowances.

COMMITTEE ON WAYS AND MEANS,
U.S. House of Representatives,
Washington, D.C.

GENTLEMEN: The cost of the bags used in the Gilsonite industry in connection with the bagging of the Gilsonite should be included as a part of the ordinary treatment process as defined under section 114(b)(4)(B), as it is proposed to be amended.

The cost of the bags is as much a part of the process as is any other phase of bringing the Gilsonite to a marketable product. The Government might argue that bags are not within the definition of mining properties and thus should not be properly included as a part of the ordinary treatment process. Such an argument is erroneous, in that it confuses the basic reason for depletion with the statutory and arbitrary formula set up for effecting the depletion allowance.

It is unrealistic to include the bagging process without also including the cost of the bags. It would be just as unreasonable to include loading for shipment as an ordinary treatment process but attempt to exclude the cost of operating any of the equipment or implements employed in loading for shipment. We are concerned with the process of bringing Gilsonite to a marketable form. The use of the bags is incident to the process involving Gilsonite.

Therefore, it is strongly recommended that the cost of the bags be included as one of the elements under the definition of "ordinary treatment process" involving Gilsonite.

Very truly yours,

E. H. OWEN.

THE CARBON LIMESTONE CO.,
Lowellville, Ohio, March 3, 1959.

Hon. WILBUR D. MILLS,
Chairman, Committee on Ways and Means,
U.S. House of Representatives,
Washington, D. C.

MY DEAR MR. MILLS: The bill relating to percentage depletion of minerals and ores, as proposed by the U.S. Treasury Department, is highly inappropriate for the crushed stone industry.

The processing of stone is primarily concerned with the breaking and screening of stone into various sizes. Stone is the beginning product and stone is the end product; therefore, no expensive finished product is involved as is the case with many other minerals and ores. Indeed, the processes of mining and converting stone from its original state to a condition suitable for sale is quite similar to the processes of mining and converting coal from its original state to a salable condition.

We earnestly urge the House Ways and Means Committee to adopt the proposals presented by the National Crushed Stone Association. These proposals are the product of intensive study by crushed stone producers and would result in a percentage depletion bill for crushed stone that would be clear, concise, fair and easy to interpret and which would bring to an end the constant litigation that inevitably results from bills such as that proposed by the Treasury.

GEORGE H. DONALDSON,
President.

CENTROPOLIS CRUSHER CO.,
Kansas City, Mo., March 11, 1959.

Re proposed amendments to section 613, Internal Revenue Code, 1954.

Hon. WILBUR D. MILLS,
Chairman, Committee on Ways and Means
U.S. House of Representaives, Washington D.C.

DEAR CONGRESSMAN MILLS: In the 30 years of this company's existence, we have never felt it necessary to burden a Member of Congress with any of our problems or complain of any mistreatment, whether fancied or real; however, in connection with the hearings now being held by the Committee on Ways and Means, on certain amendments, which the Treasury Department has proposed to section 613 of the 1954 Revenue Code, dealing with the percentage depletion allowance, I thought you might, since it has been mentioned by others in the testimony, be interested in an account of the experiences which this one taxpayer has had with percentage depletion as it has been administered in the past by the Treasury Department. Although ours is but a small company, I find in conversations with other producers that our own experience is rather typical of the problems which the industry as a whole had had with these almost annual changes in the percentage depletion "ground rules."

As you will recall, percentage depletion first became available to producers of limestone in October of 1951. The law was then changed to permit producers of "metallurgic and chemical grade limestone" to deduct as their allowance for depletion a certain percentage of their gross income from mining, mining being defined to include all the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral products. This seemed to be simple enough even for the lay taxpayer since both terms, metallurgical and chemical grade limestone and ordinary treatment processes, were well enough understood by those in the industry. Accordingly, in our tax returns for 1951, 1952, and 1953 we deducted a sum equal to the stated percentage of our income derived from these processes.

In July of 1953, however, the Treasury Department issued a regulation stating, in effect, that, regardless of what Congress had said, "metallurgical and chemical grade limestone" would not be treated as "metallurgical and chemical grade limestone" unless the producer actually sold it to the metallurgical and chemical industry. Since our company although it produced a metallurgical or chemical grade of limestone, did not sell all of its product to the metallurgical or chemical industries, the Internal Revenue Service in a 1954 audit disallowed the deduction we had taken in the 3 years preceding the issue of their regulation. After more than a year of numerous hearings and conferences at the various administrative levels, we paid the difference in tax (which incidentally amounted to more than the total capital of this company) and filed a claim for refund. After another round of hearings and conferences the claim was, in view of the disparity between the regulation and the statute, denied.

On March 1, 1956, suit was filed in the United States District Court for the Western District of Missouri. In spite of the repeated efforts of the Service to prevent it from so doing (in the interval the present Justice Whittaker, who had just been appointed to the district court when this case was filed, completed his service on the Court of Appeals for the Eighth Circuit and served one full term on the Supreme Court of the United States), this case was finally tried on November 6, 1958. Since there had never been any question as to the ultimate facts and since the regulation had in the meanwhile been invalidated in numerous decisions, Judge Smith's decision, reported at page 33 of volume 168 of the Federal supplement, was, of course, in favor of the plaintiff. The only expert produced by the Government was an engineer from the Internal Revenue Service, a Joseph Berman, who testified, not as to what the words of the statute meant or as to the commonly understood meaning thereof, but as to what the Service would have it mean. Mr. Berman is kept very busy so testifying these days in numerous cases, although I would imagine that his effectiveness has been somewhat diminished by the recent comment of Judge Johnston in the case of *Blue Ridge Stone Corp.* v. *U.S.* W.D. Va. February 15, 1959, —— F. Supp. ———, 3 A.F.T.R. 663:

"The defendant's only witness was Joseph Berman, B.A., M.A., an experienced geologist who is employed by the Engineering and Valuation Section of the Internal Revenue Service. Mr. Berman does not recognize any rock as dolomite unless it contains at least 90 percent of the mineral dolomite and is suitable for

use as a refractory, a flux, or a source of magnesium. Notwithstanding the congressional intent that the word 'dolomite' is to have its commonly understood commercial meaning, Mr. Berman feels that such a classification is too loose, and that the Tax Court erred in its holding in Virginia Limestone, supra. In view of the fact that Mr. Berman's views are in conflict both with the holdings of the Tax Court and with the stated congressional intent, his testimony cannot be considered as decisive in this case."

Nevertheless, the Service's efforts to forestall, possibly until the statute of limitations has barred the claims of all who have not kept fully abreast of each of their tactics, the publication of a final determination of this question continue. After expiration of the maximum time we were served with a notice of appeal. Although the steps to perfect such an appeal are to be taken "promptly," the Government has taken no steps whatever to prosecute this appeal. In short, 8 years later we are still not allowed to take the deduction which Congress granted us in 1951 and to which every court in the land has held us to be entitled.

I am reliably informed that this is not an isolated instance, that taxpayers all over the country have been forced to take this matter to the courts. This is true not only of the limestone industry, one of the largest and most fundamental to the economy; but also of the cement, tile, shale, sand, and gravel, dolomite, quartzite, and other industries which the 1951 law was intended to aid. The cost to the Government as well as to these taxpayers in time, expense, and legal fees must be tremendous. So much so that any benefits Congress intended they should have have been virtually eliminated. Although not a single case has sustained their position, the Government continues to litigate this question, obliging the Government for what must amount to millions of dollars in interest at the statutory rate of 6 percent. I would think that, even today, the Government could borrow money at a cheaper rate.

I have burdened you with the above history of this one case in order that you might more deeply appreciate the effect these annual adjustments in the percentage depletion law have upon the average taxpayer. As I understand the proposed amendments they would serve only to prolong rather than abate this continuing struggle. Apparently the Treasury Department is by this amendment attempting to incorporate into the law, thereby it would seem impliedly admitting that it has never been the law, the position it has taken by pure administrative fiat with the taxpayers these past 8 years. At least it now apparently recognizes that it is the function of the Congress, and not the Internal Revenue Service, to enact changes in the internal revenue laws. Sometimes I begin to wonder if the Service has not concluded that the most effective way to destroy the percentage depletion deduction, which Congress had the effrontery to enact over its objections, is to keep the producers so busy with tax litigation that they cannot earn any income against which they might apply the prescribed percentages.

I am not here attempting to discuss the merits of the proposed amendment, which I am sure is being capably handled by others at the hearings; however, because of my experience I felt it appropriate to advise you of some of the problems with which a taxpayer can be confronted in the administration of even a clearly written statute. The amendment proposed is hardly that. As I read the proposal it would serve only to make the statute much more vague and give rise to more unending litigation. I have always felt that the prime requisite of any tax statute should be that it be clear in expression and practical in its application. If it takes more than 8 years for a taxpayer to obtain a determination of his correct tax liability under a statute as clear as the present depletion statute, how long would it take under the unclear and ambiguous type now proposed? If the manifest intent of Congress can be so long thwarted when clearly expressed, how long and how effectively might it not be nullified when couched in the ambiguous language and uncertain terms of the proposed amendment?

Thanking you for your interest in this matter, I remain,

Very truly yours,

CENTROPOLIS CRUSHER CO.,
JAMES E. BURKE,
Secretary-Treasurer.

THE NATIONAL LIME AND STONE CO.,
Findlay, Ohio, March 3, 1959.

Hon. WILBUR D. MILLS,
Member of Congress, House Office Building,
Washington, D.C.

DEAR REPRESENTATIVE MILLS: A bill is pending before the House Ways and Means Committee, and the Senate Finance Committee, which is of grave concern to limestone and lime producers in Ohio and other States. The bill is sponsored by the Treasury Department, and its purpose is to raise additional revenue by cutting down depletion allowances to mineral producers, including limestone quarry operators, available under existing law. However, the bill poses a serious threat to the limestone and lime industry, and any apparent advantage in increased revenue resulting from the bill would be offset by the damage it would inflict upon the limestone business, and the thousands of employees and customers who are dependent upon that important industry.

The National Lime & Stone Co., upon whose behalf this letter is written is a large producer of limestone and lime, with nine operating limestone quarries and two lime plants in northwestern Ohio. Its products are sold to steel mills and foundries for metallurgical purposes, to highway contractors for roadbuilding, to railroad companies for ballast, to glass, paper, and other chemical process companies for a variety of chemical purposes, and to farmers for correcting soil acidity. It employs over 500 men in carrying on its operations, and supplies hundreds of customers in Ohio and other States.

National Lime & Stone is only one of many limestone and lime producers in northwestern Ohio; in fact, the industry is of great importance in the economy of the State. Ohio ranks third among the States of the Union in tonnage of limestone produced, and first in the production and sale of lime. It is for this reason that I am directing your attention to this proposed legislation, which if enacted into law, will strike a crippling blow to this vital industry.

The bill, described as one "to specify processes which shall be considered mining for the purpose of computing percentage depletion in the case of minerals and ores," etc., would strike from the present statute the definition of mining which includes as a part of mining the ordinary treatment processes normally applied to obtain "the commercially marketable mineral product or products," and substitute a new definition, including ambiguous and undefined terms, which would inevitably result in confusion, controversy and expensive litigation in the courts.

Moreover, the bill seeks to define "mining" by specifying the allowable treatment processes for the various minerals; and provides that certain processes are allowable only if applied to the "crude minerals." Although the term "crude minerals" is not defined by the statute, the Treasury regulation proposed for the 1954 code defines "crude mineral product" as the mineral in "the form in which it emerges from the mine." Therefore, it is entirely probable that the Internal Revenue Service would apply the new law and the regulation in such a way as to eliminate from "mining" all treatment processes subsequent to crushing in the primary crusher—with the result that all other operations such as secondary crushing, grinding, conveying, screening, sorting, scrubbing, storing, etc., necessary to create a marketable product, would be cut off from "mining," and hence would not be taken into account for percentage depletion purposes.

This result would not only be unrealistic and contrary to any fair concept of mining, but would be fatal to profitable operation in the limestone industry.

Furthermore, the bill does not define terms included, such as "crushing," "grinding," and "fine pulverization"; provides that "mining" does not include "any treatment process which follows a process not considered as mining"; and unrealistically specifies the treatment processes considered as "mining" to mean the processes necessary to render the mineral "transportable" rather than "marketable." In short, the bill is not concerned with whether "mining" results in a salable mineral; instead, it would make the test whether the mineral can be transported.

The bill is highly objectionable to this company and to the entire limestone industry in the foregoing respects, and in other respects mentioned in the analysis of the provisions of the bill hereto attached. In fact, if adopted, the bill in my considered opinion will impair the financial integrity of the industry and its

ability to serve its customers and the public as it has done heretofore. For these reasons, I respectfully urge you to investigate the bill and to work and vote against it in order to protect limestone and lime producers, their employees, and the important customers they serve throughout the State.

Respectfully yours,

THE NATIONAL LIME & STONE CO.,
C. PAUL PALMER, *President.*

Enclosure: Comments on amendments to the depletion statute proposed by the Treasury.

COMMENTS ON AMENDMENTS TO THE DEPLETION STATUTE PROPOSED BY THE TREASURY

The Treasury Department is sponsoring an amendment to the Internal Revenue Code which would radically change the definition of "gross income from the property" placed in the statutory tax law by the Revenue Act of 1943. In that Revenue Act, "gross income from the property," was defined as "gross income from mining" with "mining" being defined as including not merely the extraction of ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products.

The present proposal of the Treasury Department would do away with the test of "treatment processes applied to obtain the commercially marketable mineral product" and substitute in its place certain "treatment processes" regardless of whether or not at the end of such processes there was a commercially marketable mineral product, and would, therefore, eliminate one of the main reasons for the action of Congress in placing in the tax statutes provisions for percentage depletion.

According to the legislative history one of the chief reasons for allowing depletion on a percentage basis was to assure to the Commissioner of Internal Revenue, as well as to the taxpayer, simplicity in computing and handling depletion of natural resources. Under the definition presently in the law, all the taxpayer has to do in computing his percentage depletion is to take the gross sales price of his commercially marketable product or products and apply the percentage figure prescribed in the statute. The amount of the allowance, however, is limited to 50 percent of the taxpayer's net income (computed without allowance for depletion).

Likewise, when such a taxpayer's return is audited all the revenue agent has to do is check the accuracy of the computations. Under the proposed amendment, however, should any of the treatment processes not be considered as mining, the Revenue Service, as well as the taxpayer, will be obliged in some form or fashion to apportion the total costs and profits between the treatment processes considered as mining and the treatment processes not considered as mining in order to arrive at his "gross income from the property."

It is immediately apparent that the proposed amendment to the code (assuming for the moment that the treatment processes described in the amendment were subject to definitive interpretations) would materially enlarge the Commissioner's cost of administering the tax program, multiply the number of bona fide conflicting interpretations, thereby necessarily increasing the number of claims and lawsuits, and provide the Government, as well as the taxpayer, absolutely no assurance as to what the tax liability of the taxpayer for a given period will be.

By specifying the treatment processes which shall be considered as mining and the treatment processes which shall not be considered as mining, the amendment sponsored by the Treasury Department would destroy to a great extent the flexibility of the present statute needed to meet the changing technological advancements in the processing of minerals. This would be achieved by the elimination of the word "include" before the specification of the treatment processes. Under the present law, the word "include," according to its statutory definition, shall not be deemed to exclude treatment processes other than those specifically mentioned in the statute.

Not only does the proposed amendment completely change the present theory of percentage depletion, but the language of the amendment is vague, undefined, and at times contradictory. One of the outstanding examples of such an undefined, vague term is the use of "crude minerals" in section 613(c)(3)(C). This term evidently is intended to cover an extremely large category of natural

resources but, inasmuch as the words are not defined, it is impossible to ascertain their meanings. It is imperative to know their meanings, because if "crushing, grinding, sorting, screening, washing, and drying to remove free moisture" are applied to such a crude mineral, such processes are, under the proposed amendment, "treatment processes considered as mining" and thus a part of the "gross income from the property." The present proposed Treasury regulation for the 1954 Internal Revenue Code (reg. 1.613–3) defining "crude mineral product" is of no help and merely increases the ambiguity. This regulation defines "crude mineral product" as the mineral in the form in which it emerges from the mine. Under such a definition, if applied to limestone, it could be plausibly argued that after the initial or primary crushing, the limestone is no longer a crude mineral and thus further "crushing, grinding, sorting, screening, washing, and drying to remove free moisture" could have no applicability. By such an interpretation, percentage depletion for producers of limestone would for all practical purposes be eliminated.

Section 613(c)(3)(C) of the amendment is further confused by the use of the above-mentioned undefined word "grinding," because it is directly contrary to section 613(c)(4)(A). It is to be noted that in section 613(c)(3)(C) "grinding" is a treatment process considered "mining," whereas in section 613(c)(4)(A) it is expressly provided that "fine pulverization" is a treatment process not considered as mining. These words may cover and describe the same process, yet supposedly one is considered as mining and the other is not. Such contradictory provisions can lead to nothing but uncertainty, confusion, and additional administrative expenses. Thus, it is apparent that a taxpayer mining limestone cannot know what his "gross income from the property" is and neither can the Internal Revenue Service.

Other provisions of the proposed amendment are bound to give rise to claims, controversies, and lawsuits. Illustrative are sections 613(c)(3)(C)iv and 613(c)(4)(A).

Section 613(c)(3)(C)iv provides that necessary additional processes applied to bring the mineral to physical form and condition in which it is capable of being transported are considered as part of mining, whereas processes applied to make the mineral salable are not considered as a part of mining. Frequently, the question will arise as to whether a certain process is applied to make the mineral salable or whether it is applied to place the mineral in a form and condition suitable for shipment. Of course if the process is applied to make the mineral salable, then such process may not be considered in computing the gross income from the property on which income the amount of percentage depletion is determined. On the contrary, if the process is applied to put the mineral in a form and condition suitable for transportation, it may be included in the gross income from the property. Likewise, the meaning of "necessary" in this section will give rise to additional controversies.

Section 613(c)(4)(A) uses the undefined word "refining" as one of the treatment processes not considered as mining. Certainly such a vague, undefined term will do nothing but cause difficulty and expense in administration. The provisions mentioned are illustrative of some of the problems involved in the suggested legislation.

The proposed amendment will practically eliminate any depletion for mine owners or operators producing lime from their limestone, even though they must calcine a portion of their output to be able to sell their product. Section 613(c)(4)(A) of the proposed amendment provides that "calcining" and "treatment effecting a chemical change" are not treatment processes considered as mining, and section 613(c)(4)(B) provides that any treatment process following a process not considered as mining is not to be considered as mining. Thus, the calcining process, as well as subsequent treatment processes, and possibly even earlier processes applied after the primary crushing of the limestone, may not be included in the gross income from the property.

For these reasons, the proposed legislation threatens the prosperity and economic well-being of the limestone and lime industry, which is an important segment of the economy of the State, and this, in turn, would jeopardize the jobs of workers at limestone quarries and lime plants and deprive industry, farmers, and other customers of an adequate supply of these essential minerals. The advantage of increased revenue resulting from the bill would be small as compared to the harm it would produce to the limestone industry and the thousands of persons dependent upon it. In fact, revenue might actually be reduced under the bill because of the effect on the financial strength of producers and the probable cut in production.

STATEMENT OF FRANKLIN WITMER, PRESIDENT, PULVERIZED LIMESTONE ASSOCIATION

Mr. Chairman and gentlemen of the committee, my name is Franklin Witmer. I am president of the Pulverized Limestone Association and am vice president of Ohio Lime Co. at Woodville, Ohio. Our association fully endorses the statement made by Mr. Philip L. Corson before your committee on March 6, 1959, in behalf of the National Lime Association.

We believe that much of the language proposed by the Treasury Department, if enacted into law, would create a great deal more confusion than the present statute, particularly in regard to the allowable ordinary treatment processes and the proposed deletion of the phrase "commercially marketable mineral product or products." We believe, in view of the experiences of members of our association, and as has already been testified before this committee, that the many problems we now have in arriving at a price for our stone will be multiplied by the proposed language. This is a very troublesome problem, for one reason due to the lack of uniformity of administration of the law and regulations, and it is our recommendation that the taxpayer be given an election as to whether he takes field or market price, or uses the proportionate profits method.

Inasmuch as now, more than 7 years after enactment, the provisions of the 1951 amendments have not been fully clarified, it would seem most unfortunate for the numerous changes of the type under consideration to be made, which would undoubtedly start another long period of uncertainty, controversies, and litigation.

There appears to be no sound reason for excluding fine pulverization as a mining process. The difference between grinding and fine pulverization is one of degree only and it would be difficult of ascertainment, with the Treasury labeling any fine grinding as fine pulverization and the taxpayers, on the other hand, contending that fine pulverization is only a degree of grinding, to determine where the breakpoint occurs. In our industry it is necessary to process our minerals through grinding, or fine grinding, to produce a marketable product. Inconsistently the Treasury proposes to permit the fine grinding or "fine pulverization" of talc as an ordinary treatment process, but would disallow this grinding in the case of limestone.

The Pulverized Limestone Association asks that it be treated on an equitable and equal basis with all other minerals, and particularly that its position competitively not be jeopardized. Again we say to the committee that the proposal of the Treasury will only add to the confusion which already exists.

STATEMENT OF ROBERT M. KOCH, PRESIDENT, NATIONAL AGRICULTURAL LIMESTONE INSTITUTE, INC.

This statement is submitted on behalf of the National Agricultural Limestone Institute, Inc., and its members.

The institute represents 441 members located in 31 States. Its members account for about 75 percent of the limestone produced in the United States for agricultural purposes. The institute urges the Ways and Means Committee to reject several of the proposals contained in the Treasury Department's bill on percentage depletion.

AGRICULTURAL LIMESTONE INDUSTRY

The product of our industry is clean limestone, chemically suitable for agricultural use. Our producers work certain limestone deposits and apply a series of processes in order to obtain this product. The processes normally applied by our operators in order to obtain agricultural limestone are crushing, screening, washing, drying, grinding, bagging, and loading for shipment. These simple processes reduce the size of the stone as it comes from the quarry, they clean the product, and they prepare it for shipment.

TREASURY DEPARTMENT'S PROPOSAL

There are three measures in the Treasury Department's bill which the National Agricultural Limestone Institute urges the Ways and Means Committee not to adopt. The three measures are:

(1) To throw out the rule under which mining includes the ordinary treatment processes normally applied by mineowners or operators in order to obtain

the commercially marketable mineral product or products, and substitute a list of specific processes which are considered as mining.

(2) In the case of most minerals to exclude "fine pulverization" from the list of mining processes.

(3) To exclude the cost of packaging unless this is necessary to bring the mineral to the physical form and condition in which it can be shipped, as distinguished from being applied to make the mineral salable.

COMMERCIALLY MARKETABLE MINERAL PRODUCT RULE

Under the commercially marketable mineral product rule, agricultural limestone producers are in general entitled to apply the limestone depletion rate against the f.o.b. selling price of their product in determining their depletion allowances. The institute believes this is an entirely proper procedure, particularly in view of the limited nature of the processes applied by our industry.

In place of the simple procedure which can be followed in computing depletion allowances under the commercially marketable mineral product rule, the Treasury Department's proposal would substitute an involved and ambiguous list of processes which are allowed in the depletion computation. This substitution would plunge the Treasury Department and taxpayers into endless controversy over application of the treatment process provisions. It would substitute a complicated method of determining depletion allowances involving theoretical allocations of costs and profits and necessitating bookkeeping procedures and accounting methods which are far too intricate for the average agricultural limestone producer.

PULVERIZATION

The National Agricultural Limestone Institute believes there are a number of reasons why fine pulverization should not be excluded from the list of mining processes. First, there is a problem of statutory consistency. The Treasury Department's proposal would exclude fine pulverization in the case of most minerals and ores, but it would include pulverization in the case of talc. Surely the Ways and Means Committee does not wish to approve such discriminatory treatment.

Second, there is a problem of statutory interpretation. Under the Treasury Department's bill it is necessary to distinguish between "crushing" and "grinding," on the one hand, and "fine pulverization," on the other. Any such distiction will be either too broad to be workable or too narrow to be fair. Moreover, if "fine pulverization" is to be excluded, is "pulverization" includible? If it is, what is the difference between the two?

Third, and most important, the exclusion of fine pulverization is unrealistic when applied to the agricultural limestone industry. The product of this industry is subject to State laws and Federal regulations. Attached is a table showing the degree of grinding or pulverization required for agricultural limestone under these laws and regulations. Unless limestone sold for soil conditioning is ground to these specifications it cannot be used under the agricultural conservation program. This program accounts for 80 percent of the agricultural liming materials used in this country.

BAGGING

The Treasury Department's proposal would exclude the cost of packaging unless needed to bring the mineral to the physical form and condition in which it is capable of being transported as distinguished from being applied to make the mineral salable. In many areas where the terrain renders bulk spreading of agricultural limestone impossible, it is necessary to pack in sacks for delivery to the farmers. Packaging thus is essential in order to obtain a marketable product. The institute believes that in the interest of having a simple consistent depletion computation procedure, packaging should be allowed in computing the depletion deduction.

CONCLUSION

For the reasons stated, the National Agricultural Limestone Institute urges the Ways and Means Committee to reject the three measures included in the Treasury Department's bill and discussed above.

Mechanical analysis requirements for standard ground limestone by States, 1959 agricultural conservation program—USDA

State	Mechanical analysis			
	Primary sieve		Secondary sieve	
	Percent	Mesh	Percent	Mesh
Alabama	90	10	50	60.
Arkansas	90	10	40	60 or 25 through 100.
California	90	10		
Connecticut	98	20	40	100.
Delaware	100	10		
Florida	50	20		
Georgia	90	10	25	100.
Illinois	80	8		
Indiana	80	8	25	60.
Iowa	80	8		
Kansas	90	8	25	100.
Kentucky	80	10		
Louisiana	90	8	25	100.
Maine	98	20	40	100.
Maryland	90	20		
Massachusetts	98	20	40	100.
Michigan	85	8	25	100.
Minnesota	80	8		
Mississippi	90	8 or 10		
	80			
Missouri	95	8	25	100.
New Hampshire	98	20	40	100.
New Jersey	98	20	40	100.
New York	98	20	40	100.
North Carolina	100	10	50	100.
Ohio	95	8	40	100.
Oklahoma	100	4	90 and 30	8.
				60.
Pennsylvania	98	20	40	100.
Rhode Island	98	20	40	100.
South Carolina	90	10	50	50.
Tennessee	85	10	50	40.
Texas	75	10	30 and 15	40.
				100.
Vermont	98	20	40	100.
Virginia	90	10	20	100.
Washington	90	8	20	100.
West Virginia	90	10	50	60.
Wisconsin	80	8	35	60 or 100.
			20	

STATEMENT OF L. J. KNAPP, SECRETARY-TREASURER, THE GROUND LIMESTONE ASSOCIATION

The Ground Limestone Association respectfully submits the following statement in an attempt to express its urgent request that consideration be given by the committee to rule against the adoption of the recent proposals by the Internal Revenue Service to change certain regulations pertaining to percentage depletion. In 1951 Congress granted percentage depletion to additional industries including the stone industry in general. This was done to correct existing tax inequities and to place them in a competitive position to attract invested capital on the same basis as other natural resources industries. Since 1951 the limestone industry has been in a constant state of turmoil created by the fact that the Internal Revenue Service has chosen to interpret this law to such a degree that the intent of Congress was completely circumvented. Numerous cases have been tried in both Federal and tax courts with the overwhelming majority of the decisions in favor of the taxpayer.

The proposed new provisions appear to be primarily an effort on the part of the Treasury Department to include regulations which maintain the position of the Commissioner in the cases that have been litigated and lost. As an example there appears to be no reason for excluding "pulverizing" as a mining process. The difference between "fine grinding" and "fine pulverization" is one of degree only and it would be difficult to ascertain where fine grinding stops and pulverization begins or vice versa. Moreover, there is no more factual evidence proving that pulverization of talc is a part of the ordinary treatment

process and pulverization of limestone is not. In both instances the mine owner is seeking a commercially marketable product.

If the percentage depletion law were to be changed in accordance with the present Treasury suggestions it is felt certain that only complete chaos and many new additional lawsuits would result for the terminologies create many contradictory understandings and interpretations. We, therefore, urge that these proposed regulations not be adopted and that the Commissioner be urged to recognize the authority of the courts which have in most cases handed down decisions in accordance with the intent of Congress.

(Whereupon, at 5:35 p.m. the committee recessed to reconvene at 10 a.m., Friday, March 6, 1959.)

MINERAL TREATMENT PROCESSES FOR PERCENTAGE DEPLETION PURPOSES

FRIDAY, MARCH 6, 1959

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met at 10 a.m., pursuant to recess, in the committee room, New House Office Building, Hon. Wilbur D. Mills (chairman) presiding.

The CHAIRMAN. The committee will come to order.

Our first witness this morning is Hugo E. Johnson, president of the American Iron Ore Association, of Cleveland, Ohio.

STATEMENT OF HUGO E. JOHNSON, PRESIDENT, AMERICAN IRON ORE ASSOCIATION; ACCOMPANIED BY LEONARD A. SPALDING, JR., HEAD, TAX DEPARTMENT, PICKANDS MATHER & CO.; ROLAND G. SMITH, TAX ATTORNEY, PICKANDS MATHER & CO.; AND J. R. GREENLEE, TAX MANAGER, THE M. A. HANNA CO., CLEVELAND, OHIO

Mr. JOHNSON. Mr. Chairman, members of the Ways and Means Committee: My name is Hugo E. Johnson, president of the American Iron Ore Association, whose member companies produce over 90 percent of the iron ore mined in the United States.

With me today I have several members of the tax committee of our association, Mr. John Greenlee of the M. E. Hanna Co., Mr. Roland G. Smith of Pickands Mather & Co., and Mr. Leonard A. Spalding from Pickands Mather & Co.

Before commenting on the Treasury Department's suggestions for revision of section 613 of the Internal Revenue Code in connection with percentage depletion, I should like to make a few qualifying remarks about the iron ore mining industry, its customs, practices, and terminology.

Iron ore has been mined in the United States since before the American Revolution. In the early days of the iron ore mining industry, it was the practice to mine the higher grade iron ores which were suitable for use in the iron and steel furnaces without any beneficiation. These high-grade ores were known in the trade as ore of "shipping grade." That is to say, they were of a quality suitable for use as a raw material feed by the Nation's iron and steel industry, without further processing, for "shipping" to the steel producing areas by boat or by rail.

As the iron and steel industry increased its productive capacity to meet the greater demands brought on by the two World Wars and the increasing level of our standards of living, the iron ore mining industry expanded its production to meet these needs.

In order to meet the Nation's insatiable demand for raw materials to feed the iron and steel furnaces, it became obvious that the iron ore industry would have to look to sources other than its dwindling reserves of high-quality, or "shipping grade," ores to maintain production. It was known that there were vast quantities of iron ores locked in the ground which nature had not concentrated to the high iron and low silica content of "shipping grade" ores. Since the "shipping grade" ores had been concentrated by nature through thousands of years of leaching, the first experiments in beneficiation of the low-grade ores involved simple washing processes to remove undesirable waste materials such as silica from the ore and thus to increase the iron content of the ore to make it comparable to the ordinary "shipping grade" ores.

Subsequent processes developed to beneficiate low-grade iron ores involved washing and jigging the crude material to aid in the concentrating process. Heavy-media processes were later added to further aid in separating the iron ores from the undesirable gangue (waste) materials in order to bring the ore to "shipping grade."

The continuing demand for ever-increasing quantities of iron ore and the rapid depletion of our reserves of ores capable of being brought to "shipping grade" by simple concentrating techniques led the industry to develop further improved methods for concentrating which involved more complex "flow sheets" including the use of grinding, washing, heavy-media, spirals, and so forth, in order to concentrate the crude ores to an ore of "shipping grade." Due to variations in the structure of the crude ores treated, some iron ore concentrates can be taken from the flow of materials going through the beneficiating plant after the first or second stage of concentration. The balance of the crude in which the iron-bearing material is more closely locked in with the waste materials might then require finer grinding and the use of spirals and heavy-media separation to release the iron ore and allow further concentration to bring it to suitable "shipping grade" iron ore.

The finely ground ores, although equal in iron content to "shipping grade" ores, proved more difficult to handle than the direct-shipping, high-grade iron ores; and when fed directly into the blast furnace, there was a substantial loss due to fines blowing out of the stack. It soon became apparent that the minute particles would have to be brought together to provide a suitable form for the beneficiated ore to bring it to "shipping grade." The process of bringing together these minute iron ore particles to make a form suitable of "shipping grade" is known in the trade as "agglomeration." Variations of this agglomerating process are known as sintering, pelletizing, nodulizing, and briquetting.

Twenty-five years ago only 16 percent of the total iron ore mined in the United States was beneficiated. Today at least half of the iron ore consumed in the United States must be treated by beneficiation, including agglomeration, to bring it to "shipping grade" (as that term is known historically) so that it will be an acceptable raw material for the Nation's iron and steel furnaces.

During the past 5 years the iron mining industry has invested $1 billion of private capital in developing the mines and building the concentrating plants necessary to free the iron content (approxi-

mately 30 percent) which is locked in to the extremely hard rock formations known as "taconites" or "jaspers." These concentrating plants utilize the "ordinary treatment processes" commonly used by mineowners or operators, such as crushing, grinding, magnetic separation, or flotation, and subsequent agglomeration in order to bring the ore to "shipping grade," thus assuring a continuing supply of raw materials to the iron and steel industry so vital to this country.

The members of the American Iron Ore Association agree in principle with the Treasury Department's proposal to eliminate "marketability" as a criterion in the determination of the cutoff point for percentage depletion purposes.

It is our understanding that the Treasury Department in its draft of the proposed legislation relating to percentage depletion has no intention of disturbing previous administrative practice. We feel, however, that the present Treasury draft fails to make that intention clear, and the deletion of any specific language applicable to the "ordinary treatment processes" in the case of iron ore is disturbing to the members of our association.

Present code (section 613) specifically states that sorting, concentrating, and sintering are "ordinary treatment processes" in the case of iron ore, thus continuing to recognize those processes which have been named in the code ever since their incorporation in the 1939 Revenue Act (as amended in 1943).

Administratively the Internal Revenue Service has recognized all of the beneficiating processes referred to above as being "ordinary treatment processes" as they are applied to iron ore. "Sintering" is the broad term applied to agglomeration whereby fine ores or iron ore concentrates are agglomerated to produce an acceptable raw material for the iron and steel industry; other methods of agglomeration are pelletizing, nodulizing, and briquetting.

We urge that any legislation that this committee recommends on this subject specify that agglomeration of iron ore is a mining process for percentage depletion purposes.

We also believe that the scope of section 613(c)(4)(B) of the Treasury proposal, whereby any intervening nonmining process would eliminate a subsequent mining process, is not clear and suggest that this section be modified to delineate more specifically the areas intended to be covered.

We are familiar with the proposals presented to this committee yesterday by Lincoln Arnold, the American Mining Congress, and endorse the views expressed by them.

Mr. Chairman, and members of this committee, we are grateful for this opportunity to appear before you to present the viewpoints of the members of the American Iron Ore Association.

The CHAIRMAN. Mr. Johnson, as I understand, you do not question the intent of the Treasury Department as expressed by Mr. Lindsay in the changes that they propose to make in this draft. What you question is whether or not the language itself actually carries out the intent expressed by Mr. Lindsay on behalf of the Treasury Department.

Mr. JOHNSON. That is it, yes.

The CHAIRMAN. Any questions of Mr. Johnson?

If not, Mr. Johnson, we thank you and the other gentlemen with you for coming to us this morning to give us the benefit of your views.

Mr. JOHNSON. Thank you, Mr. Chairman.

The CHAIRMAN. Our next witness is Mr. Lohmann of the National Coal Association.

Mr. Lohmann, for the purposes of the record, would you please identify yourself and the gentleman who is sitting with you?

STATEMENT OF HOWARD E. LOHMANN, CHAIRMAN, TAX COMMITTEE, NATIONAL COAL ASSOCIATION; ACCOMPANIED BY RICHARD L. HIRSHBERG, ASSISTANT COUNSEL, NATIONAL COAL ASSOCIATION, WASHINGTON, D.C.

Mr. LOHMANN. My name is Howard E. Lohmann. I am treasurer of the Ayrshire Collieries Corp., Indianapolis, Ind., and chairman of the tax committee of the National Coal Association. It is in the latter capacity that I appear here today. The National Coal Association is the trade organization of bituminous coal mine owners and operators throughout the United States. Its members mine more than two-thirds of the commercially produced bituminous coal in this country. We have also been authorized to speak for the American Coal Sales Association, the Anthracite Institute, the Bituminous Coal Operators' Association, and the Southern Coal Producers' Association.

I am accompanied by Richard L. Hirshberg, assistant counsel of the National Coal Association, who will also be available to answer questions concerning the coal industry's position on this proposed legislation.

My purpose in testifying before your committee is to explain the coal industry's position on the Treasury proposal specifying the treatment processes which shall be considered mining for the purpose of computing percentage depletion in the case of mineral products (app. A). The Secretary of the Treasury announced his intention to propose such legislation on January 26, 1959, citing the budget message of the President submitted to Congress on January 19. Hearings were announced by you, Mr. Chairman, on February 9, and the Treasury draft was released on February 12.

Anticipating that the Treasury draft might affect the coal industry even though it would apparently not be directed toward us, the assistant counsel of our association wrote to your chief counsel on February 10 (app. H), and volunteered my services as a witness. You have very graciously allotted me the full 30 minutes requested for the presentation of oral testimony. Knowing that the committee has a full schedule ahead of it, I shall try to keep my statement well within the time limit. With this intention, I request permission of the chairman to submit drafts and other documents for the record rather than read them aloud.

The CHAIRMAN. Without objection, Mr. Lohmann, you will have that permission.

Let me announce that certain members of this committee who are also members of the Joint Committee on Internal Revenue Taxation will have to absent themselves from the room before you complete your statement. We regret that it will not be possible for us to hear your full statement, but you may be assured that we shall read it, and if we are absent when others testify this morning, we will read their statements, as well.

You may proceed.

Mr. LOHMANN. I have stated the chronology of these hearings in order to emphasize the limited time available to us and to other affected industries to study the Treasury draft and to make what we hope are constructive suggestions. We recognize that the provisions of section 613 governing gross income from "mining," as interpreted by some courts, have resulted in unintended discrimination as between taxpayers within the same segment of the mining industry. We also believe that the Secretary's reference, in his transmittal letter to the Speaker of the House, dated February 11, 1959, to "making certain that appropriate treatment is given all affected industries," indicates a sincere desire to preserve legitimate depletion allowances to the mining industry generally, just as his letter of January 26 shows an understandable purpose to prevent what he considers unjustified losses of revenue. We hope that our comments will be of assistance to your committee in evolving satisfactory solutions to the many problems in this important area.

In computing depletion allowances for coal, there are several basic concepts which must be considered. Some of the principles apply also to other extractive industries, but I shall confine myself to our own problems. (In the term "coal," whenever mentioned, I include "lignite.") The broad statutory authorization for depletion is (sec. 611(a), Internal Revenue Code of 1954):

> In the case of mines * * * there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion * * *, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under regulations prescribed by the Secretary or his delegate.

At the risk of sacrificing some element of suspense, I will state at the outset that the existing code definition of "gross income from the property" is, in our opinion, presently adequate to the demands of its rather limited role in the determination of "a reasonable allowance for depletion" in the case of coal. We advocate no change in statutory "gross income" and we are not aware of any reason why the Secretary of the Treasury should object to the status quo as to coal in this respect.

The next statutory provision particularly affecting coal is the special rule relating to leases, which provides (sec. 611(b)(1)):

> In the case of a lease, the deduction under this section shall be equitably apportioned between the lessor and lessee.

The effect of this provision on the depletion allowances of coal mine owners and operators is currently being considered by the Supreme Court of the United States in two companion cases, *Huss* v. *Smith* and *Parsons* v. *Smith*, which were argued March 4, 1959.

Since 1951, the Internal Revenue Code has contained a special provision governing disposal of coal with a retained economic interest. The statutory language, which was somewhat modified in 1954, provides in part (sec. 631(c)):

> In the case of the disposal of coal (including lignite), held for more than 6 months before such disposal, by the owner thereof under any form of contract by virtue of which such owner retains an economic interest in such coal, the difference between the amount realized from the disposal of such coal and the adjusted depletion basis thereof, plus the deductions disallowed for the taxable year under section 272, shall be considered as though it were a gain or loss, as the case may be, on the sale of such coal. Such owner shall not be

entitled to the allowance for percentage depletion provided in section 613 with respect to such coal * * *.

A correlative code section provides in part (sec. 272):

Where the disposal of coal is covered by section 631, no deduction shall be allowed for expenditures attributable to the making and administering of the contract under which such disposition occurs and to the preservation of the economic interest retained under such contract * * *.

The code deals with the subject of basis for cost depletion of coal in a general section application to all natural resources (sec. 612).

The statutory fun again begins (speaking from the Philadelphia lawyer's point of view) with the provisions for computing percentage depletion (sec. 613). The general rule, with which I am sure you are all familiar, may be briefly stated as providing an allowance of the lower of two figures: a specified percentage of "gross income from the property," or "50 percent of the taxpayer's taxable income from the property" (sec. 613(a)). It is further provided that "in no case shall the allowance for depletion under section 611 be less than it would be if computed without reference to" section 613.

The term "gross income from property" means (except for oil and gas wells) the gross income from "mining" (sec. 613(c)(1)). The term "mining" includes three categories of operations: (1) "The extraction of the ores or minerals from the ground"; (2) "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products"; and (3), in general, "so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles" (sec. 613 (c) (2)).

Some of the words and phrases within the statutory definition of "mining" (which is itself a part of the definition of "gross income") are also defined in the code. The term "extraction of the ores or minerals from the ground" is, in part, defined to include "the extraction by mine owners or operators of ores or minerals from the waste or residue of prior mining" (sec. 613(c)(3)). The term "ordinary treatment processes," to which the Treasury draft is addressed in detail, is defined to include some specifically stated processes for some specific minerals and for broad categories of minerals and also some generally stated processes for specific minerals and broad categories of minerals. Some processes are expressly excluded.

Other words and phrases in the definition of "mining" lack any statutory definition. Notable among these is the phrase "the commercially marketable mineral product or products" (which the courts have interpreted contrary to the Treasury's views).

Another definition which is conspicuous by its absence from the Code is that of "the taxpayer's taxable income from the property" (sec. 613(a)). This term is of vital importance where 50 percent of "taxable income" is less than the specified percentage (in the case of coal, 10 percent) of "gross income" and where the former figure exceeds depletion based on cost. Under such circumstances (the very existenec of which must be determined to some extent without aid from the statute), 50 percent of "taxable income" is, in fact, the amount of the allowance for depletion.

The next important term in computing both cost and percentage depletion for coal is "property" (sec. 614). A separate depletion computation must be made for each "property" (sec. 612, 613, and 614). This word is generally defined as "each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land" (sec. 614(a)). There are many intricate exceptions to and qualifications of this general rule, both in section 614 as originally codified in 1954 and in the additions and changes made by the Technical Amendments Act of 1958.

Exploration expenditures may be deducted in the case of coal, at the election of the taxpayer and within certain specified limitations (sec. 615). Development expenditures may be deducted, also optionally but without limitation as to time or amount (sec. 616). The deduction of exploration expenditures under section 615 with respect to a "property," as defined in section 614, may result in a tax benefit (through the computation of percentage depletion) which the taxpayer would not have realized had he elected to combine this "property" with another at the time of such expenditures, rather than later. Under such circumstances, the code contains elaborate provisions for the recomputation of the tax and the recoupment of this benefit by the Treasury (sec. 614(c)(4)).

The purpose of this brief review of statutory provisions is to point out that the computation of depletion for coal is a subject comprehensively regulated by Congress, except for the large gap left by the omission of "taxable income" from the roster of code definitions. He who seeks amendment of any of these complicated and interrelated provisions should, I believe, be required to show clearly and convincingly the desirability of and the necessity for the proposed change. In the interest of fairness, this standard should be applied to the Government and the taxpayer alike when either is in the position of a proponent of legislation.

Revenue loss alone should not be regarded as justifying a sweeping revision of tax laws affecting importantly large segments of industry. We ask, therefore, that your committee searchingly examine the Treasury proposal in the light of the testimony adduced in the present hearings, as well as with the aid of your own broad experience in revenue degislation and that of your professional staff. In considering this major proposal to amend section 613, I suggest that your committee take this opportunity to review thoroughly the basic theory of depletion. Both the Treasury draft and counterproposals submitted by industry should be scrutinized in connection with this thoroughgoing reexamination of the depletion allowances, in order to avoid repeated requests both by the Treasury and by affected taxpayers for further corrective legislation in the future.

We have a number of specific objections to the Treasury draft. My brief listing of some examples is not to be construed as a general statement that the draft has no other obvious or latent defects. Limitations of time, both for careful study of the draft and for the presentation of testimony, preclude the listing of all of its possible adverse effects on coal.

First, the changing of "includes" to "means" in section 613(c)(2), and the elimination of "includes" from section 613(c)(4), would impose straitjacket limitations on the definition of "mining" which do

not exist in present law. The same effect would probably follow from the deletion of the phrase "normally applied by mine owners or operators" in section 613(c)(2).

As a specific example of the effect which this change would have on coal, I cite the process of "blending" of different sizes and qualities of coal, which we think is clearly allowable under the present law, but would be either prohibited or highly doubtful should the code be amended as suggested by the Treasury Department. It looks as if the effect of the proposed language would be to limit the processes allowable for coal strictly and literally to "cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment," without any leeway for the exercise of reasonable administrative discretion (sec. 614(c)(4)(A)).

A second objection is the proposed changing of the words, "the term 'ordinary treatment processes' includes the following:", in section 613(c)(4), to read:

> The following treatment processes where applied by the mine owner or operator with respect to the minerals or ores extracted from the ground by him, shall be considered as "mining:".

Many of our companies make arrangements with independent contractors, under varying terms and conditions, to extract coal from the ground and deliver it back to them for the performance of some of the presently allowable treatment processes. Under the Treasury's draft, we are afraid that the value added by such processes (performed by the owner of the mineral on his own coal) would be arbitrarily excluded from the depletion base. The Treasury's witness testified yesteday (March 5) that the Treasury draft did not get into the contractor question at all. In spite of this statement of intention, we believe that any amendment enacted should expressly exclude coal, so as to forestall a large number of lawsuits.

Such an important change in present law should not even be considered by your committee, I submit, until the Supreme Court has decided the coal contractor cases of *Parsons* v. *Smith* and *Huss* v. *Smith* (argued March 4, 1959), which involve the definition of "economic interest." Briefly stated, the question in those cases is who gets the depletion deduction, rather than how much the deduction is, but the two issues are obviously interrelated. "Economic interest," incidentally, is another term which Congress has not seen fit to spell out, though it is of great importance in the computation of depletion allowances.

A third provision that might have a considerable adverse effect on coal is the addition of an entirely new proposed section 613(c)(4), entitled "Treatment processes not considered mining." This rather confusing provision excludes from the definition of "mining" (and thus from the depletion base) certain specified processes, "unless such processes are otherwise provided for in paragraph (3)," and also, excludes "any treatment process which follows a process that is not considered as 'mining,'" "notwithstanding any other provisions of this subsection."

Again without going into great detail, I want to point out that (whether intended to or not) this proposal could possibly exclude presently allowable processes if they were preformed after any process which was considered not to be "mining." The cited language would

probably make doubtful the crushing of coal for shipment by pipeline, which we believe present law makes allowable.

The Treasury draft was probably not intended to affect the present methods of computing depletion allowances in the case of coal. The above objections and examples were presented to the Treasury in a letter to Under Secretary Scribner from the assistant counsel of the National Coal Association, dated February 27, 1959, in which the latter expressed a willingness to confer with appropriate persons in the Department as to our views concerning defects in the draft submitted to your committee by the Department on February 11. Such conferences have been held but no drafting changes have been made as yet.

The coal industry further urges that a satisfactory definition of "the taxpayer's taxable income from the property" be added to section 613. This subject, which is just as important as "gross income from the property" in the computation of depletion allowances, has been a trouble spot for years. The hope that the Treasury would agree to this suggested amendment was also expressed in the above-mentioned letter to the Under Secretary.

Only recently the Commissioner of Internal Revenue has acquiesced in *U. S. Potash Co.* (29 T.C. 1071 (1958)) and *F. H. E. Oil Co.* (3 T.C. 13 (1944)), which held that charitable contributions need not be deducted in determining taxable income for percentage depletion purposes. The Tax Court's similar decision on this point in *Island Creek Coal Co.* (30 T.C. 370 (1958)), presumably will also be accepted by the Government.

If these acquiescences are correct in principle—and we believe that they are—there would appear to be no logical argument for requiring the deduction, for purposes of the 50-percent-of-taxable-income limition on depletion, of other expenses not directly attributable to the mineral property. In addition to charitable contributions, examples of these expenses are interest and State and local taxes measured by income.

Because of the express definition of "gross income from the property" in the statute, both the Treasury and the courts have been strict in excluding items of income unless they are literally covered by the statutory concept of "mining," which the Treasury is now urging should be even further restricted. It seems equitable that only items of expense reasonably analogous to the items of income includible by statute in "gross income from the property" should be required to be deducted in computing "taxable income from the property."

The underlying purposes of the 50 percent limitation is not served by penalizing the mine operator who happens to choose or require debt rather than equity financing, or who is unfortunate enough to operate in a State where income or gross receipts taxes are high, or who is public spirited enough to make charitable contributions. The justification for the 50 percent limitation is evidently the encouragement of mineral extraction from the most economically recoverable deposits, lest the depletion deduction operate as a reward for haphazard mining of marginal deposits. Furthermore, the limitation should operate to the benefit of the efficient, and hence low-cost, mine operator. None of these considerations is present when the law operates to penalize mine operators by reason of expenses in no way

related to the economical recoverability of the mineral or the efficiency of the mining operation.

Especially is the need for clarification of "taxable income" apparent in the light of the changes made by the Technical Amendments Act of 1958, which increased the possible number of "properties" which a taxpayer could own. A separate depletion computation must be made for each "property," and if "taxable income" remains undefined the uncertainties inherent in the computation of each taxpayer's depletion allowance will be multiplied by the number of "properties" owned by him.

A draft is attached embodying the coal industry's suggestions with respect to a satisftcory statutory definition af "taxable income from the property." We hope that your committee and the Treasury Department will agree as to the validity of the principles involved in this important area. We are willing and anxious to work cooperatively with both your staff and the Treasury tax staff in the development of such legislation, which will be of long-term benefit to the Government as well as to taxpayers in reducing uncertainties and the consequent burden of interpretation and litigation.

As far as the definition of the term "gross income from the property" is concerned, we offer no suggested draft because of our belief that the present law, in its application to coal, has operated satisfactorily to the Treasury Department as well as to the industry since its amendment in 1954. In other words, we do not believe that "excessive depletion allowances" have inured to coal because of defects in the present statutory definition of "gross income," or that such a result is reasonably foreseeable through judicial interpretation of this term in relation to coal.

When asked yesterday, March 5, whether the proposed draft was intended to affect the present methods of computing depletion allowances in the case of coal, the Treasury witness said that he did not believe it was. We suggest that this exception be clearly stated in the draft itself, so as to preclude the possibility of a mass of lawsuits on the subject. This result could be easily accomplished by including the phrase "except in the case of coal and lignite" at some appropriate point or points in the amendment.

I wish to thank your committee again for its generous allotment of time to explain the position of the National Coal Association. I appreciate having had the opportunity to appear and testify.

Mr. HARRISON (presiding). Does that complete your statement?

Mr. LOHMANN. That completes my statement.

The CHAIRMAN. Any questions?

Mr. Baker?

Mr. BAKER. When I read this draft, my impression was that it had no effect whatever on the coal industry, because the same language is used on page 2, as you know. That is the same langauge exactly that is in the 1954 code. You do not seem to include it in any way under treatment processes not considered in mining.

I am not disputing your testimony, but as far as the specific language of either section, processes considered mining and processes not considered mining, coal is not referred to at all, is it?

Mr. LOHMANN. These processes that are specifically listed as included or excluded do not mention certain processes which we feel

might automatically not qualify under the Treasury draft as included processes, such as, for instance the blending of two sizes of coal. As long as the definition says that the thing includes certain processes, it is all right; but when you restrict it to say that it means certain processes, then you might eliminate some of those processes.

Mr. BAKER. That goes back to this big word "means," which we had so much discussion about yesterday, as to whether the word "means" should be substituted for the word "includes." Of course the word "includes" is far more comprehensive.

You would be in the same shape, then, that you are under the present law?

Mr. LOHMANN. Yes.

Mr. BAKER. I do not think there is any doubt about that. If the word "includes" was in the bill, instead of "means," it seems to me you would be on all fours with the 1954 code. Am I right, Mr. Hirshberg?

Mr. HIRSHBERG. I agree that upon first reading of the Treasury draft, and perhaps upon repeated readings of the Treasury draft, that might appear to be the effect. However, I submit that we would be affected even though the word "includes" were restored.

Now let me mention the specific language changes that the Treasury would make other than that. In the present (c)(2)——

Mr. BAKER. You are talking about the 1954 code?

Mr. HIRSHBERG. I am talking about the present 1954 code.

Mr. BAKER. And what part is that?

Mr. HIRSHBERG. 613(c)(2), which is appendix E of our testimony.

Mr. BAKER. I have it right in front of me.

Mr. HIRSHBERG. You have:

The term "mining" includes not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products.

Now, in the Treasury draft, that would be changed. The Treasury draft is appendix A to our testimony. That would be section 1(b)(1) of the draft, starting at the bottom of our appendix A and at the top of page 2.

The term "mining" means the extraction of the ores or minerals from the ground.

That much is not changed. Treatment processes considered as mining are described in proposed paragraphs (3) and (4), which section 1(b)(3) of the draft would substitute for section 613(c)(4) of the 1954 code. I shall omit the reading of the transportation provision, because that is not changed. But by limiting it to "treatment processes considered as mining described in paragraphs (3) and (4) "of the proposed legislation, the Treasury would repeal the words "normally applied by mine owners or operators."

Mr. BAKER. It would repeal more than that. It would repeal the words "includes not merely."

Mr. HIRSHBERG. Yes, sir, it would. And I think that further reenforces the interpretation that I put on this draft, of an intention to straitjacket the processes considered as mining, rather than leave some leeway for the exercise of administrative discretion and judicial interpretation. The Treasury Department has stated its intention primarily of eliminating the troublesome phrase, "the commercially

marketable mineral product or products," which, incidentally, has not been troublesome with respect to coal. So we do not think—and our thought on what was reenforced by questioning by Mr. Harrison yesterday and replies by Mr. Lindsay—that they were trying to affect coal depletion allowances at all. But while eliminating "commercially marketable mineral product or products," I feel that they have also rather glibly and perhaps unintentionally eliminated this other language, "processes normally applied," which does indicate a congressional intent to allow for differences within a particular industry of modes of operation, differences between industries, and furthermore, differences in methods of operation which may arise in the future.

For example, we have one company at the present time which is shipping coal by pipeline. That requires grinding it up rather fine and suspending it in water. I do not know whether or not they consider that a treatment process. I believe as a matter of law it might well come within the present language of "loading for shipment." However, if you will turn again to our appendix A, which is the Treasury draft, there is a specific exclusion contained in quoted paragraph (4)(A):

(A) In the case of all minerals or ores—electrolytic deposition, roasting, calcining, thermal or electric smelting, refining, polishing, fine pulverization, blending with other materials, treatment effecting a chemical change, thermal action, and molding or shaping, unless such processes are otherwise provided for in paragraph (3).

Fine pulverization, assuming that is necessary to get the coal ready for shipment in a pipeline, would be "loading for shipment" under the present law; but under this clause, which at first appears to override the loading for shipment provision and then says, "unless otherwise provided for," so that you really do not know which overrides which—I think the pulverization would be either disallowed or at least made highly doubtful, because in (3) of the Treasury draft, coming to (A)—as you have pointed out, Mr. Baker—you have the same language in that particular small subparagraph of the proposed draft as you do in the 1954 code; but you have to look beyond that, because of these other changes that the Treasury proposes to make.

In (C) of that same paragraph, small Roman (iv)—I am sorry this is getting so involved, but it is just the way the draft is written—you have—

In the case of all other minerals or ores, (iv) any additional process, if necessary, to bring the mineral or ore to form and condition suitable for shipment.

That provision, and in fact all of (C), are not, in my view, applicable to coal, for the simple reason that coal is covered specifically in another subparagraph. And I believe a court would interpret that as meaning that in the case of coal Congress intended to restrict the allowed processes very literally to the words in (A), and in the case of all other minerals or ores, which are covered by (C), Congress intended to give some leeway for administrative or judicial interpretation in the use of the general wording that I have just quoted.

Mr. BAKER. I agree with you thoroughly, because in subparagraph (C), in the case of "all other minerals," that would exclude the ones that are specifically set out.

Mr. HIRSHBERG. I would say so, sir.

Mr. BAKER. In the 1954 code, (c)(2), the existing law is that the term "mining" includes "not merely the extraction of the ores or

minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products." And so much for the transportation, and so forth.

Now, the language of the draft, which would take the place of that section, is:

Treatment processes considered as mining.—The following treatment processes where applied by the mine owner or operator with respect to the minerals or ores extracted from the ground by him shall be considered as "mining."

In your case it names cleaning, treating, sizing, dust allaying, treating to prevent freezing, and loading for shipment. In the proposed formula, that is all you could do. Now, there has to be one of two things done, if present practices which are now recognized, in addition to those enumerated ones, are to continue. That is to specifically enumerate, number one, number two, put back some such language as I just read from (c) of the 1954 code. Is that right?

Mr. HIRSHBERG. Yes, sir. I think that either coal should be excepted entirely from any effect of this amendment, as we suggest, or that some such language should be restored.

I would like to say for the record, knowing that this will one day be part of the legislative history, that in the unfortunate event that this Treasury draft does become law, I do not want to be interpreted as saying here that, "We don't think that we would be allowed to do certain things." I merely want to say, Mr. Chairman and Mr. Baker, that we think that this draft raises doubts as to the legality of doing certain things, and it certainly raises potential difficulties in dealing with the Treasury personnel who will be drafting the regulations and issuing the rulings.

Mr. BAKER. I would go further than that in support of your position, and say that the draft language might result in that interpretation. But apparently, from Mr. Lindsay's testimony before this committee, that was not the intention of the Treasury.

Mr. HIRSHBERG. I agree, sir.

Mr. BAKER. But it does require some elements, either to put in more general terms which are in the 1954 code, or, not only in the instance of coal but every other such mineral, to clearly delineate in plain language what is considered mining for the purpose of the statute. And that is going to be a tremendous task, if you clearly delineate every one of them. And you cannot look forward to, as Lincoln Arnold so well said, taking care of improved technology in the future. We cannot today write a statute and take care of improved technical improvements in the future, as I see it.

Mr. HIRSHBERG. No. And I think that since the gentleman from Tennessee has mentioned the time element, you could also point out that the regulations under the 1954 code have not been put in final form yet. That is, although they have been printed in the Federal Register on November 3, 1956, they are of absolutely no legal force and effect as long as they remain in the proposed form. While the Treasury Department is proposing this and other changes in the law, they have not even been able to "finalize," as the bureaucratic word is, their interpretations of the existing law.

Now, we feel that if a draft such as this is made applicable to coal and lignite—and perhaps to other minerals, although we do not speak

for them—which are not intended to be touched, you are going to have a difficult problem of interpretation by the Treasury Department; that there will be a further time lag. People cannot keep their tax years open forever. At least, they do not want to. And you will have, in short, what might be considered pretty much of a mess.

I realize that I, as a lawyer, should not be saying this. Perhaps Mr. Lohmann—who is not a lawyer—should be, because it will give a lot of business to the lawyers. But I do not think it is a satisfactory situation, particularly in the face of a specific statement by a Treasury official that this draft was not intended to touch coal at all.

I believe we have shown that the Treasury draft does touch coal very considerably, regardless of the intention, and that in interpreting this draft or this law, if it should unfortunately become one, both the Treasury personnel, who are writing regulations and rulings, and eventually the courts, will look first at the clear wording of the law. If the clear wording of the law says this or that process is cut off, they will not, on settled judicial principles, go back of that and look at the committee reports, and especially they will not look at these hearings. I think it is clear that the courts will just look at the law, especially if it is in a complicated field like this, and will feel that since Congress has legislated so specifically and in such careful detail in other areas affecting depletion, Congress certainly knew what it was saying when it wrote the law.

That is why we have gone perhaps a little boringly into some of the other provisions affecting the depletion allowance for coal, to bring out that all these statutory provisions are interrelated. You cannot touch one of them without upsetting the applecart on others.

Another very sweeping change that this draft would make, Mr. Lindsay indicated yesterday and Mr. Glasmann indicated to me informally a few days ago it was not intended to make at all; in fact, it was not even intended to affect this problem. It is pertaining to independent contractors, whose right to depletion is now being litigated before the Supreme Court of the United States. The cases were argued earlier this week. Under this draft, in the provision that Mr. Baker has pointed out, the Treasury would substitute "The following treatment processes where applied by the mine owner or operator with respect to the minerals or ores extracted from the ground by him shall be considered as 'mining.' "

Mr. BAKER. And the words here, at least, could be interpreted to limit it to that particular operator.

Mr. HIRSHBERG. I think they might well be, Mr. Baker. That is entirely new language, as the committee well knows. It not only changes the word "includes," but it changes that whole introductory sentence. I believe that if the Supreme Court decides this case as we of the National Coal Association think it should be decided, and holds that the contractor who did not have a feehold or leasehold interest in the mineral at any time is not entitled to depletion, in that event it might possibly be argued that this independent contractor, though not such under common law principles, was an agent of the original owner of the mineral in place, and therefore, by a stretching of the language, "by him" would mean "by this independent contractor." However, I believe that that is highly doubtful, because an independent contractor is not an agent.

On the opposite assumption, that the Supreme Court awards this independent contractor a depletion allowance based on the Court's holding that this independent contractor has an economic interest of his own in the mineral, I think it would not only be highly doubtful but almost impossible to argue that "by him" made the independent contractor, who now has his very own depletion allowance, an agent of the man who originally had the economic interest and agreed to part with some of it.

The reason for this is that by awarding this contractor an economic interest, the Court would be making him analogous to either a lessor, or a lessee. The statute now says, and has said for many years, that in the case of a lease, the depletion allowance shall be equitably apportioned between the lessor and the lessee. In other words, each one has his own independent claim to part of the depletion allowance. That is why, in computing the gross income limitation, you exclude from the gross income of the mine operator the rents or royalties, so that you will not have two people deducting for the same depletion.

So that is just another example of the type of questions raised by this draft, and they are very serious questions from our point of view.

Our position, in short, is that since the present law defining "gross income" has operated satisfactorily to the industry, and since there is no complaint by the Treasury Department, we respectfully submit that the committee should not change such present law as it affects coal.

Now, you might say that——

Mr. BAKER. If I could interrupt you there: How could you do it that way? If you restore the language of the 1954 code, where it "includes not merely" and so forth, that would apply to everybody and would include presently accepted treatment processes in addition to the enumerated ones; but how could you say that as to coal?

Mr. HIRSHBERG. We have explained that, Mr. Baker, in a footnote.

Mr. BAKER. What justification would there be for doing that for coal and not for any other minerals? Presumably there are many others that are substantially in that category.

Mr. HIRSHBERG. I think that you have raised a very good point, sir, that presumably there are other minerals in the category that the Treasury did not intend to touch. I believe that if the committee and its staff is to do a proper job on this proposed amendment—assuming that you intend to act at all or decide to act at all on it—it would be appropriate to find out by getting the Treasury representatives and affected taxpayers together and having statements such as were made a part of the record yesterday made a matter of agreement between the Treasury and the taxpayer. For instance, I think it was demonstrated clearly by Mr. Harrison's questioning that the Treasury did not intend to affect coal; but I think it has been demonstrated equally clearly by our analysis of the draft this morning that it does affect coal, regardless of the intention.

If the Treasury and your staff and industry representatives could all get together in conferences, as has been done before, and list the minerals that the Treasury does not intend to affect, and draft an exception for them, I believe that it would make your job a great deal easier in drafting a possible amendment to affect what the Treasury does think needs affecting. It would certainly make the job of

the courts and the people who are going to be writing these regulations simpler in the future.

The only people that it could possibly injure are those "Philadelphia lawyers" that Mr. Lohmann so graciously referred to in his statement, who probably delight in having these technicalities written into the law.

Mr. BAKER. Well, if you did that, if you made that elimination, then you can say what are the treatment processes to be considered in that industry and what are not to be considered, and that they should not apply to any other segment. That is in effect what you are saying?

Mr. HIRSHBERG. Yes, sir. Of course, as I have pointed out, we are speaking only for the coal industry. That is all that we can speak for. I do not even know that the American Mining Congress officially agrees with everything that I have said, or that Mr. Lohmann has said. We did not get full clearance, for the simple reason that the time was short, and, as they said, they had a hard enough time clearing their own draft without undertaking the clearance of ours.

Mr. BAKER. Of course, the gentleman who just preceded you, representing iron ore, said it seems all right to them. "Just be sure we are not affected, and it is all right."

Mr. HIRSHBERG. That may be so, that the draft does not affect them. I have not analyzed it from the standpoint of iron ore, but I do think that the approach that we have been discussing would be sensible.

Mr. BAKER. I say with all due respect to the gentleman who preceded you: When I first read this draft—I read it more than once and compared it with the code—I felt it did not affect the code. I see now that it does; by this general language, certainly it does.

The same thing is going to apply to iron ore and every other segment of the mineral industry, regardless of the specific language.

Mr. HIRSHBERG. Yes, sir; I believe that is obviously the effect.

Now, I would like to point out that last year the Secretary of the Treasury came before your committee and specifically singled out brick and cement. As I remember, there were no other minerals mentioned. This year, there was some general language—and you would expect it to be general—in the President's budget message about depletion allowances for minerals. That was on January 19.

On January 26, a letter from the Secretary of the Treasury to the Speaker and the Vice President contained some slightly more specific language, but it was still in general terms. It mentioned brick and cement, but it indicated a clear intention to affect some other minerals, an unnamed number of other minerals, and we did not know on what basis or on what theory or philosophy these other minerals were to be affected, so that we did not know whether or not, at that point, the draft would apply to coal.

For that reason, when Mr. Mills announced on February 9 that hearings were to be held in the very near future, I wrote a letter to the chief counsel, Mr. Irwin, on February 10, in effect reserving 30 minutes of time, because I was afraid that no matter what the Treasury's good intentions were, it would seriously affect us. And the Treasury's draft, of course, was released 2 days after that, and frankly came as quite a shock to me, because I had always thought of this as

the brick and cement amendment. I had thought that they intended at the Treasury Department to exclude coal and other minerals that were in their eyes not offending from the point of view of computing gross income. I also assumed that, having had a year and a half to work on it, they would come up with a draft that had that effect. I really do not believe that this draft does have that effect.

Mr. BAKER. Last year, when the Secretary's letter came to the committee, my construction of it was that we were being asked to remedy conditions in respect to brick and cement, on the theory that the Supreme Court, or the courts, had interpreted the 1954 code in those instances contrary to our intent. That is one way of facing the problem, and it could well be done in the future, and it could even be made retroactive. That would be one justification for retroactivity. If this committee and the Congress said, "We did not intend any such thing as that and therefore it should be retroactive," it might be harsh; but instead of that, we have the entire subject program, presumably to accomplish that more narrow purpose. And that has disturbed me.

You are going to have a set of rules from August of 1954 to the effective date of this act, and then start out again with this one, and it will be some time before you have any effective regulation.

I am not saying we should not have some legislation; maybe it should be limited to certain ones they say were not the intent of Congress.

Mr. HIRSHBERG. That is our position, sir. We are not saying that you should not have some legislation; on the other hand, we are not affirmatively saying that you should. We feel that if these alleged excessive depletion allowances are actually more than Congress intended, it is up to the Treasury Department to bear the burden of proving that to your committee and the rest of the Congress, and it is not up to us to help them. We are satisfied with the present law defining "gross income" as it affects coal, and we do not see any reason why it should be changed. That is the "short" of our position.

Mr. BAKER. We are not asking you to do that.

Mr. HIRSHBERG. Of course, I have not gotten to the "taxable income" question at all, but I think, as our presentation and the appendixes indicate, it is all tied up with the computation of depletion allowances. Obviously you cannot look at gross income without looking at taxable income, for the simple reason that if you cut off some processes from computing gross income, certainly the expense of performing those processes should not be deducted in computing taxable income.

For instance, take containers. If you cut off the cost of putting things in bags or containers, and also the cost of those containers, from the depletion base in figuring gross income—so that the value added by those processes is not taken into consideration in the gross income part of the equation—then quite evidently it would be highly unfair to leave those costs as deductions in computing taxable income, which of course ties in with the 50 percent limitation.

That is why we urge, as this subject becomes more and more complicated—of course, it became rather complicated last year—probably you will say that was our fault—in section 614, defining "property," and if this sort of legislation is enacted it will become still more com-

plicated—and assuming that Congress wants to legislate in a detailed regulatory manner, that Congress should give the courts the aid of some specific legislation on taxable income, because it is all part of the same equation.

In other words, Congress should not leave room for the Treasury Department to argue at some future date that, although the value added by a particular process is specifically excluded by the statute from the gross income computation, in some way it should be attributed or allocated to the mining property for purposes of cutting down the taxable income part of the depletion computation.

And I do not think it is entirely inconceivable that such an argument could be made, bearing in mind that for years and years the Department argued that charitable contributions should be allocated to the mineral property, although the Tax Court disagreed with them, and they finally acquiesced in the two cases that I have mentioned, and probably will in the third.

The acquiescence, incidentally, is in rather grudging terms (appendix G). I will not read the whole thing, but it indicates that no one is safe in deducting a contribution to a hospital. That is, no businessman or corporation is safe in claiming that that is a charitable deduction, because the Treasury, by its Technical Information Release 125 accompanying the acquiescence, has indicated that it reserves the right to argue that such a contribution was an ordinary and necessary business expense and not a charitable contribution, and therefore the acquiescence does not apply to it.

For example, if a mining company in Bluefield, W. Va.—I have no idea what the hospital situation is there—should decide to give a large sum of money to a hospital in Bluefield, and should decide to deduct that as a charitable contribution with the applicable limitations on charitable contributions being taken into account, the Treasury might come back and argue that that is not really a charitable contribution; that it has a business purpose, because the employees of this mining company are going to be the chief beneficiaries of the hospital, and the mining company is indirectly increasing their wages by making such a contribution. There, again, you have a large mass of litigation in sight to straighten the matter out.

Furthermore, we know that these acquiescences do not always stick. For instance, in the recent case in the United States Supreme Court involving the deduction of expenses to influence legislation, the Commissioner had acquiesced for many years in the Luther Ely Smith case, allowing such expenses to be deducted under some circumstances. After the case got into the Supreme Court, in what the lawyer for the taxpayers termed "a post motam litem flip-flop," the Treasury Department withdrew its acquiescence in Luther Ely Smith, and said it was all a mistake from the beginning. You do not have to issue a notice of proposed rule making in the Federal Register as an introduction or as a warning that an acquiescence is going to be withdrawn.

Mr. HARRISON (presiding). Any further questions, gentlemen?

If not, we thank you very much for your appearance.

Mr. HIRSHBERG. Thank you, Mr. Chairman, for your generous allotment of time to us.

(The prepared statement of Howard E. Lohmann, including attachments, is as follows:)

STATEMENT OF HOWARD E. LOHMANN, CHAIRMAN, TAX COMMITTEE, NATIONAL COAL ASSOCIATION ON TREASURY DEPARTMENT'S PROPOSAL TO AMEND SECTION 613 OF THE INTERNAL REVENUE CODE OF 1954

My name is Howard E. Lohman. I am treasurer of the Ayrshire Collieries Corp., Indianapolis, Ind., and chairman of the tax committee of the National Coal Association. It is in the latter capacity that I appear here today. The National Coal Association is the trade organization of bituminous coal mineowners and operators throughout the United States. Its members mine more than two-thirds of the commercially produced bituminous coal in this country. We have also been authorized to speak for the American Coal Sales Association, the Anthracite Institute, the Bituminous Coal Operators' Association, and the Southern Coal Producers' Association.

My purpose in testifying before your committee is to explain the coal industry's position on the Treasury proposal specifying the treatment processes which shall be considered mining for the purpose of computing percentage depletion in the case of mineral products (appendix A). The Secretary of the Treasury announced his intention to propose such legislation on January 26, 1959,[1] citing the budget message of the President submitted to Congress on January 19. Hearings were announced by you, Mr. Chairman, on February 9, and the Treasury draft was released on February 12.

Anticipating that the Treasury draft might affect the coal industry even though it would apparently not be directed toward us, the assistant counsel of our association wrote to your chief counsel on February 10 (appendix C) and volunteered my services as a witness. You have very graciously allotted me the full 30 minutes requested for the presentation of oral testimony. Knowing that the committee has a full schedule ahead of it, I shall try to keep my statement well within the time limit. With this intention, I request permission of the chairman to submit drafts and other documents for the record rather than read them aloud.

I have stated the chronology of these hearings in order to emphasize the limited time available to us and to other affected industries to study the Treasury draft and to make what we hope are constructive suggestions. We recognize that the provisions of section 613 governing "gross income from mining," as interpreted by some courts, have resulted in unintended discrimination as between taxpayers within the same segment of the mining industry. We also believe that the Secretary's reference, in his transmittal letter to the Speaker of the House, dated February 11, 1959,[2] to "making certain that appropriate treatment is given all affected industries" indicates a sincere desire to preserve legitimate depletion allowances to the mining industry generally, just as his letter of January 26 shows an understandable purpose to prevent what he considers unjustified losses of revenue. We hope that our comments will be of assistance to your committee in evolving satisfactory solutions to the many problems in this important area.

In computing depletion allowances for coal, there are several basic concepts which must be considered. Some of the principles apply also to other extractive industries, but I shall confine myself to our own problems. (In the term "coal," whenever mentioned, I include "lignite.") The broad statutory authorization for depletion is (sec. 611(a), Internal Revenue Code of 1954) :[3]

"In the case of mines * * * there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion * * *, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under regulations prescribed by the Secretary or his delegate."

At the risk of sacrificing some element of suspense, I will state at the outset that the existing code definition of "gross income from the property"[4] is, in our opinion, presently adequate to the demands of its rather limited role in the determination of "a reasonable allowance for depletion" in the case of coal. We advocate no change in statutory "gross income" and we are not aware of any reason why the Secretary of the Treasury should object to the status quo as to coal in this respect.

The next statutory provision particularly affecting coal is the special rule relating to leases, which provides (sec. 611(b)(1)) :

"In the case of a lease, the deduction under this section shall be equitably apportioned between the lessor and lessee."

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[1] Letter of Secretary of the Treasury, Robert B. Anderson, to Speaker of the House of Representatives, Jan. 26, 1955 (App. B).
[2] App. D.
[3] All citations are to the Internal Revenue Code of 1954 unless otherwise noted.
[4] Sec. 613(c) (app. E).

The effect of this provision on the depletion allowances of coal mine owners and operators is currently being considered by the Supreme Court of the United States in two companion cases, *Huss* v. *Smith* and *Parsons* v. *Smith*,[5] which were argued March 4, 1959.

Since 1951, the Internal Revenue Code has contained a special provision governing disposal of coal with a retained economic interest. The statutory language, which was somewhat modified in 1954, provides in part (sec. 631(c)):

"In the case of the disposal of coal (including lignite), held for more than 6 months before such disposal, by the owner thereof under any form of contract by virtue of which such owner retains an economic interest in such coal, the difference between the amount realized from the disposal of such coal and the adjusted depletion basis thereof plus the deductions disallowed for the taxable year under section 272 shall be considered as though it were a gain or loss, as the case may be, on the sale of such coal. Such owner shall not be entitled to the allowance for percentage depletion provided in section 613 with respect to such coal * * *."

A correlative code section provides in part (sec. 272):

"Where the disposal of coal is covered by section 631, no deduction shall be allowed for expenditures attributable to the making and administering of the contract under which such disposition occurs and to the preservation of the economic interest retained under such contract * * *."

The code deals with the subject of basis for cost depletion of coal in a general section applicable to all natural resources (sec. 612).

The statutory fun again begins (speaking from the Philadelphia lawyer's point of view) with the provisions for computing percentage depletion (sec. 613). The general rule, with which I am sure you are all familiar, may be briefly stated as providing an allowance of the lower of two figures: a specified percentage of "the gross income from the property," or "50 percent of the taxpayer's taxable income from the property" (sec. 613(a)). It is further provided that "in no case shall the allowance for depletion under section 611 be less than it would be if computed without reference to" section 613.

The term "gross income from the property" means (except for oil and gas wells) "the gross income from mining" (sec. 613(c)(1)). The term "mining" includes three categories of operations: (1) "the extraction of the ores or minerals from the ground"; (2) "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products"; and (3), in general, "so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles" (sec. 613(c)(2)).

Some of the words and phrases within the statutory definition of "mining" (which it itself a part of the definition of "gross income") are also defined in the code. The term "extraction of the ores or minerals from the ground" is, in part, defined to include "the extraction by mine owners or operators of ores or minerals from the waste or residue of prior mining" (sec. 613(c)(3)). The term "ordinary treatment processes," to which the Treasury draft is addressed in detail, is defined to include some specifically stated processes for some specific minerals[6] and for broad categories of minerals[7] and also some generally stated processes for specific minerals and broad categories of minerals.[8] Some processes are expressly excluded.[9]

Other words and phrases in the definition of "mining" lack any statutory definition. Notable among these is the phrase "the commercially marketable mineral product or products" (which the courts have interpreted contrary to the Treasury's views).[10]

Another definition which is conspicuous by its absence from the code is that of "the taxpayer's taxable income from the property" (sec. 613(a)). This term is of vital importance where 50 percent of "taxable income" is less than

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[5] 255 F. 2d 599, Sup. Ct. No. 305, and 58–1 USTC, par. 9390, Sup. Ct. No. 218 (both cases, C.A. 3, 1958).
[6] Sec. 613(c)(4) (A), (B), (C), (D), and (E).
[7] Sec. 613(c)(4) (C) and (D).
[8] Sec. 613(c)(4)(D).
[9] Sec. 613(c)(4)(D).
[10] *Merry Bros. Brick & Tile Co.*, 242 F. 2d 708 (C.A. I, 1957) and *Dragon Cement Co.*, 244 F. 2d 513 (C.A. 1, 1957), cert denied, both cases, 78 S. Ct. 31 and 50 (Oct. 14, 1957).

the specified percentage (in the case of coal, 10 percent) of "gross income" and where the former figure exceeds depletion based on cost. Under such circumstances (the very existence of which must be determined to some extent without aid from the statute), 50 percent of "taxable income" is, in fact, the amount of the allowance for depletion.

The next important term is computing both cost and percentage depletion for coal is "property" (sec. 614). A separate depletion computation must be made for each "property" (secs. 612, 613 and 614). This word is generally defined as "each separate interest owned by the taxpayer in each mineral deposit in each separate tract or parcel of land" (sec. 614(a)). There are many intricate exceptions to and qualifications of this general rule, both in section 614 as originally codified in 1954 and in the additions and changes made by the Technical Amendments Act of 1958.[11]

Exploration expenditures may be deducted in the case of coal, at the election of the taxpayer and within certain specified limitations (sec. 615). Development expenditures may be deducted, also optionally but without limitation as to time or amount (sec. 616). The deduction of exploration expenditures under section 615 with respect to a "property," as defined in section 614, may result in a tax benefit (through the computation of percentage depletion) which the taxpayer would not have realized had he elected to combine this "property" with another at the time of such expenditures, rather than later. Under such circumstances, the code contains elaborate provisions for the recomputation of the tax and the recoupment of this benefit by the Treasury (sec. 614(c)(4).

The purpose of this brief review of statutory provisions is to point out that the computation of depletion for coal is a subject comprehensively regulated by Congress, except for the large gap left by the omission of "taxable income" from the roster of code definitions. He who seeks amendment of any of these complicated and interrelated provisions should, I believe, be required to show clearly and convincingly the desirability of and the necessity for the proposed change. In the interests of fairness, this standard should be applied to the Government and the taxpayer alike when either is in the position of a proponent of legislation.

Revenue loss alone should not be regarded as justifying a sweeping revision of tax laws affecting importantly large segments of industry. We ask, therefore, that your committee searchingly examine the Treasury proposal in the light of the testimony adduced in the present hearings, as well as with the aid of your own broad experience in revenue legislation and that of your professional staff. In considering this major proposal to amend section 613, I suggest that your committee take this opportunity to review thoroughly the basic theory of depletion. Both the Treasury draft and counterproposals submitted by industry should be scrutinized in connection with this thorough reexamination of the depletion allowance, in order to avoid repeated requests both by the Treasury and by affected taxpayers for further corrective legislation in the future.

We have a number of specific objections to the Treasury draft. My brief listing of some examples is not to be construed as a general statement that the draft has no other obvious or latent defects. Limitations of time, both for careful study of the draft and for the presentation of testimony, preclude the listing of all of its possible adverse effects on coal.

First, the changing of "includes" to "means" in section 613(c)(2), and the elimination of "includes" from section 613(c)(4), would impose straitjacket limitations on the definition of "mining" which do not exist in present law.[12] The same effect would probably follow from the deletion of the phrase "normally applied by mine owners or operators" from section 613(c)(2).

As a specific example of the effect which this change would have on coal, I cite the process of "blending" of different sizes and qualities of coal, which we think is clearly allowable under present law, but would be either prohibited or highly doubtful should the Code be amended as suggested by the Treasury Department. It looks as if the effect of the proposed language would be to limit the processes allowable for coal strictly and literally to "cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment," without any leeway for the exercise of reasonable administrative discretion (sec. 614(c)(4)(A)).

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[11] Public Law 85–866, Sept. 2, 1958, sec. 37.

[12] Citations are to existing code sections unless otherwise noted.

A second objection is the proposed changing of the words, "the term 'ordinary treatment processes' includes the following:" in section 613(c)(4), to read: "The following treatment processes where applied by the mine owner or operator with respect to the minerals or ores extracted from the ground by him shall be considered as 'mining':."

Many of our companies make arrangements with independent contractors, under varying terms and conditions, to extract coal from the ground and deliver it back to them for the performance of some of the presently allowable treatment processes. Under the Treasury's draft, we are afraid that the value added by such processes (performed by the owner of the mineral on his own coal) would be arbitrarily excluded from the depletion base. The Treasury's witness testified yesterday (March 5) that the Treasury draft did not get into the contractor question at all. In spite of this statement of intention, we believe that any amendment enacted should expressly exclude coal, so as to forestall a large number of lawsuits.

Such an important change in present law should not even by considered by your committee, I submit, until the Supreme Court has decided the coal contractor cases of *Parsons* v. *Smith* and *Huss* v. *Smith* (argued March 4, 1959),[13] which involve the definition of "economic interest." Briefly stated, the question in those cases is who gets the depletion deduction, rather than how much the deduction is, but the two issues are obviously interrelated. "Economic interest," incidentally, is another term which Congress has not seen fit to spell out, though it is of great importance in the computation of depletion allowances.[14]

A third provision that might have a considerable adverse effect on coal is the addition of an entirely new proposed section 613(c)(4), entitled "Treatment processes not considered as mining." This rather confusing provision excludes from the definition of "mining" (and thus from the depletion base) certain specified processes, "unless such processes are otherwise provided for in paragraph (3)," and also excludes "any treatment process which follows a process that is not considered as 'mining,'" "notwithstanding any other provisions of this subsection."

Again without going into great detail, I want to point out that (whether intended to or not) this proposal could possibly exclude presently allowable processes if they were performed after any process which was considered not to be "mining." The cited language would probably make doubtful the crushing of coal for shipment by pipeline, which we believe present law makes allowable.

The Treasury draft was probably not intended to affect the present methods of computing depletion allowances in the case of coal. The above objections and examples were presented to the Treasury in a letter to Under Secretary Scribner from the assistant counsel of the National Coal Association, dated February 27, 1959, in which the latter expressed a willingness to confer with appropriate persons in the Department as to our views concerning defects in the draft submitted to your Committee by the Department on February 11.[15] Such conferences have been held but no drafting changes have been made as yet.

The coal industry further urges that a satisfactory definition of "the taxpayer's taxable income from the property" be added to sec. 613. This subject, which is just as important as "gross income from the property" in the computation of depletion allowances, has been a trouble spot for years. The hope that the Treasury would agree to this suggested amendment was also expressed in the above-mentioned letter to the Under Secretary.[16]

Only recently the Commissioner of Internal Revenue has acquiesced in *U.S. Potash Co.*, 29 T.C. 1071 (1958), and *F. H. E. Oil Co.*, 3 T.C. 13 (1944), which held that charitable contributions need not be deducted in determining taxable income for percentage depletion purposes.[17] The Tax Court's similar decision on this point in *Island Creek Coal Co.*, 30 T.C. 370 (1958), presumably will also be accepted by the Government.

If these acquiescences are correct in principle—and we believe that they are—there would appear to be no logical argument for requiring the deduction, for purposes of the 50 percent of taxable income limitation on depletion, of other expenses not directly attributable to the mineral property. In addition to

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[13] Cited above, note 5.
[14] The term appears only in sec. 631 of the code.
[15] App. F.
[16] Ibid.
[17] T.I.R.–125, Jan. 8, 1959 (app. G).

charitable contributions, examples of these expenses are interest and State and local taxes measured by income.

Because of the express definition of "gross income from the property" in the statute, both the Treasury and the courts have been strict in excluding items of income unless they are literally covered by the statutory concept of "mining," which the Treasury is now urging should be even further restricted.[18] It seems equitable that only items of expense reasonably analogous to the items of income includible by statute in "gross income from the property" should be required to be deducted in computing "taxable income from the property."

The underlying purpose of the 50 percent limitation is not served by penalizing the mine operator who happens to choose or require debt rather than equity financing, or who is unfortunate enough to operate in a State where income or gross receipts taxes are high, or who is public spirited enough to make charitable contributions. The justification for the 50 percent limitation is evidently the encouragement of mineral extraction from the most economically recoverable deposits, lest the depletion deductions operate as a reward for haphazard mining of marginal deposits. Furthermore, the limitation should operate to the benefit of the efficient, and hence low-cost, mine operator. None of these considerations is present when the law operates to penalize mine operators by reason of expenses in no way related to the economical recoverability of the mineral or the efficiency of the mining operation.

Especially is the need for clarification of "taxable income" apparent in the light of the changes made by the Technical Amendments Act of 1958,[19] which increased the possible number of "properties" which a taxpayer could own. A separate depletion computation must be made for each "property,"[20] and if "taxable income" remains undefined the uncertainties inherent in the computation of each taxpayer's depletion allowance will be multiplied by the number of "properties" owned by him.

A draft is attached embodying the coal industry's suggestions with respect to a satisfactory statutory definition of "taxable income from the property."[21] We hope that your committee and the Treasury Department will agree as to the validity of the principles involved in this important area. We are willing and anxious to work cooperatively with both your staff and the Treasury tax staff in the development of such legislation, which will be of long-term benefit to the Government as well as to taxpayers in reducing uncertainties and the consequent burden of interpretation and litigation.

As far as the definition of the term "gross income from the property" is concerned, we offer no suggested draft because of our belief that the present law, in its application to coal, has operated satisfactorily to the Treasury Department as well as to the industry since its amendment in 1954.[22] In other words, we do not believe that "excessive depletion allowances"[23] have inured to coal because of defects in the present statutory definition of "gross income," or that such a result is reasonably foreseeable through judicial interpretation of this term in relation to coal.

When asked yesterday (March 5) whether the proposed draft was intended to affect the present methods of computing depletion allowances in the case of coal, the Treasury witness said that he did not believe it was. We suggest that this exception be clearly stated in the draft itself, so as to preclude the possibility of a mass of lawsuits on the subject. This result could be easily accomplished by including the phrase "except in the case of coal and lignite" at some appropriate point or points in the amendment.[24]

I wish to thank your committee again for its generous allotment of time to explain the position of the National Coal Association. I appreciate having had the opportunity to appear and testify.

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[18] A recent case in point is *Estate of Arnett*, 31 T.C. No. 33 (1958), where it was held that interest on a judgment awarded to the taxpayer for trespassory operation of a mineral interest owned by him was not "gross income from mining." The amount of the judgment itself was held to be depletable income.

[19] Note 11, supra.

[20] See text accompanying note 11.

[21] App. H.

[22] The words "dust allaying, treating to prevent freezing" were added to "ordinary treatment processes" for coal by the 1954 code.

[23] See note 1.

[24] Precedent for this treatment may be found in sec. 37(b) of the Technical Amendments Act of 1958, adding new sec. 614(c), pars. (1) and (2) of which begin: "Except in the case of oil and gas wells * * *."

APPENDIX A

TREASURY DRAFT TRANSMITTED TO SPEAKER OF THE HOUSE OF REPRESENTITIVES, FEBRUARY 11, 1959

A BILL To specify processes which shall be considered mining for the purpose of computing percentage depletion in the case of minerals and ores, and to revise the depletion rates with respect to certain clays when used to make common brick and tile products

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. DEPLETION RATE FOR CERTAIN CLAYS AND TREATMENT PROCESSES CONSIDERED AS MINING FOR COMPUTING PERCENTAGE DEPLETION IN THE CASE OF MINERALS AND ORES.

(a) DEPLETION RATE FOR CERTAIN CLAYS.—Subsection (b) of section 613 (relating to percentage depletion rates) is amended as follows:

(1) Paragraph (3) is amended to read as follows:

"(3) 15 percent—

"(A) metal mines (if paragraph (2) (B) does not apply), rock asphalt, and vermiculite; and

"(B) if paragraph (5) (B) does not apply, ball clay, bentonite, china clay, sagger clay, and clay used or sold for use for purposes dependent on its refractory properties."

(2) Paragraph (5) is amended to read as follows:

"(5) 5 percent—

"(A) gravel, mollusk shells (including clam shells and oyster shells), peat, pumice, sand, scoria, shale, and stone, except stone described in paragraph (6);

"(B) clay used, or sold for use, in the manufacture of building or paving brick, drainage and roofing tile, sewer pipe, flower pots, and kindred products; and

"(C) if from brine wells—bromine, calcium chloride, and magnesium chloride."

(3) Paragraph (6) is amended by striking "refractory and fire clay,".

(b) TREATMENT PROCESSES CONSIDERED AS MINING.—Subsection (c) of section 613 (relating to the definition of gross income from property) is amended as follows:

(1) Paragraph (2) is amended to read as follows:

"(2) MINING.—The term 'mining' means the extraction of the ores or minerals from the ground, the treatment processes considered as mining described in paragraphs (3) and (4), and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which such treatment processes are applied thereto as is not in excess of fifty miles, unless the Secretary or his delegate finds that the physical and other requirements are such that the ore or mineral must be transported to a greater distance to such plant or mills."

(2) Paragraph (3) is redesignated paragraph (5).

(3) Paragraph (4) is deleted and the following paragraphs are inserted in lieu thereof:

"(3) TREATMENT PROCESSES CONSIDERED AS MINING.—The following treatment processes where applied by the mine owner or operator with respect to the minerals or ores extracted from the ground by him shall be considered as 'mining':

"(A) In the case of coal—cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment;

"(B) In the case of sulfur recovered by the Frasch process—pumping to vats, cooling, breaking, and loading for shipment;

"(C) In the case of all other minerals or ores—(i) where applied to crude minerals or ores—crushing, grinding, sorting, screening, washing, and drying to remove free moisture; (ii) beneficiation by concentration, and the processes necessary thereto; (iii) beneficiation by cyanidation, leaching, crystallization, or precipitation, and the processes necessary thereto; (iv) any additional process, if necessary, to bring the mineral or ore to form and condition suitable for shipment; and (v) loading for shipment. For purposes of this subparagraph, the term 'beneficiation by concentration' means the application of processes solely for the purpose of eliminating waste, or separating the mineral or ore from other minerals or ores, by gravity, flotation, amalgamation, electrostatic means, magnetic

means, or substantially equivalent processes. The processes referred to in (iv) are those processes which are necessary to bring the mineral or ore to the physical form and condition in which it is capable of being transported as distinguished from those processes applied to make the mineral or ore salable. The term 'loading for shipment' shall not include the cost of packaging unless otherwise provided for under (iv), nor shall it include the cost of containers, bags, or any similar items;

"(D) The pulverization of talc, the burning of magnesite, the furnacing of quicksilver ores, and the sintering and nodulizing of phosphate rock.

"(4) TREATMENT PROCESSES NOT CONSIDERED AS MINING.—The following treatment processes shall not be considered as 'mining':

"(A) In the case of all minerals or ores—electrolytic deposition, roasting, calcining, thermal or electric smelting, refining, polishing, fine pulverization, blending with other materials, treatment effecting a chemical change, thermal action, and molding or shaping, unless such processes are otherwise provided for in paragraph (3); and

"(B) Notwithstanding any other provisions of this subsection, any treatment process which follows a process that is not considered as 'mining' will not be considered as mining for the purpose of this subsection."

SEC. 2. EFFECTIVE DATE.—The amendment made by this Act shall be applicable only with respect to taxable years beginning after December 31, 1958.

APPENDIX B

A–429

Treasury Secretary Anderson today sent the following identical letters to the Vice President and the Speaker of the House of Representatives:

TREASURY DEPARTMENT,
Washington, D.C., January 26, 1959.

MY DEAR MR. VICE PRESIDENT: In the budget message of the President, submitted to Congress on January 19, 1959, the President stated that the Treasury Department would recommend an amendment to the Internal Revenue Code specifying the treatment processes which shall be considered mining for the purpose of computing percentage depletion in the case of mineral products.

Early last year I testified before the Ways and Means Committee on the need to revise the law in order to preclude excessive depletion deductions for the brick and cement industries. My recommendation was made as a result of a series of court cases which permitted manufacturers of brick and cement to compute percentage depletion on the basis of the selling price of the finished manufactured product rather than on the value of the clay or cement rock before it is manufactured.

It is now apparent under the court decisions that manufacturers of many other products may obtain depletion allowances based on gross income derived from the sale of finished products. This can only result in increasing the depletion deduction for all minerals severalfold—in extreme cases as much as 100 times. I do not believe that depletion on such an inflated scale is either reasonable or was intended. If permitted, the revenue losses will indeed be serious.

The problem arises because the term "mining" is defined in the statute to include the ordinary treatment processes normally applied to obtain the "commercially marketable mineral product or products" which, in many instances, may be an expensive finished product. Accordingly, in order to prevent excessive depletion allowances, I recommend the immediate elimination of the phrase "commercially marketable mineral product or products" from the statute and the substitution of a new definition of "mining" which will specify the allowable treatment processes for the various minerals.

The proposed legislation would not only prevent a substantial loss in revenue but would also help resolve difficult and complex problems in determining for many mineral industries the stage at which taxpayers first obtain a commercially marketable mineral product.

The staff of the Treasury is now preparing a draft of the proposed legislation, and in this connection would be pleased to work in cooperation with the tax staffs of the Congress in its development.

Sincerely yours,

ROBERT B. ANDERSON,
Secretary of the Treasury.

APPENDIX C

NATIONAL COAL ASSOCIATION,
Washington, D.C., February 10, 1959.

Mr. LEO H. IRWIN,
Chief Counsel, Committee on Ways and Means, House of Representatives, House Office Building, Washington, D. C.

DEAR MR. IRWIN: Yesterday Congressman Wilbur D. Mills, chairman of the Committee on Ways and Means, announced that the committee had scheduled hearings on the Treasury Department's expected proposal specifying the treatment processes which should be considered mining for the purpose of computing percentage depletion in the case of mineral products.

The National Coal Association wishes to reserve time to be heard on the Treasury Department proposal. Since such proposal has not been made public as yet, we are unable to ascertain whether and to what extent it will affect the coal industry. The amount of time required for our direct testimony should not, however, exceed 30 minutes. We represent about two-thirds of the bituminous coal producers of the United States, but there are other groups representing coal companies which may wish to submit their own testimony. We shall do our best to coordinate the views of all coal groups and urge them to allow us to speak for the industry.

I wish to point out that the question of defining income from mining for the purpose of computing percentage depletion is of vital importance to coal as well as to all of the other extractive industries. Thus, we would appreciate an opportunity to present testimony on the Treasury Department's proposal even though it might not appear to affect directly and immediately the depletion allowance for coal.

Because the matter of defining income from mining is fundamental to the equitable computation of depletion allowances, it is to be hoped that the committee will examine carefully all aspects of this problem, and will not be satisfied with a piecemeal or stopgap type of amendment. Even though the Treasury Department may urge quick action for the purpose of preventing excessive depletion allowances for certain specific minerals, it seems evident that the underlying theory and purpose of the depletion deduction must be subjected to careful scrutiny in order to avoid repeated requests by both the Treasury Department and affected taxpayers for further corrective legislative action in future years.

The existence of the alleged errors in section 613 of the 1954 code was, in effect, confirmed by the Supreme Court in October, 1957, when it denied certiorari in the *Merry Bros. Brick and Tile Co.* and *Dragon Cement Co.* cases. Inasmuch as the Treasury Department has had nearly a year and a half to think about its proposal since the Supreme Court made final the previous interpretations of lower courts, it would seem only fair and reasonable to allow affected taxpayers at least a few months in which to study and comment on this proposal after it has finally been made public.

Our witness will probably be Mr. Howard E. Lohmann, treasurer, Ayrshire Collieries Corp., Big Four Building, Indianapolis, Ind., who is also chairman of the National Coal Association Tax Committee. Please send me duplicate copies of all correspondence with Mr. Lohmann relating to these hearings.

Very truly yours,

RICHARD L. HIRSHBERG,
Assistant Counsel.

APPENDIX D

THE SECRETARY OF THE TREASURY,
Washington, February 11, 1959.

Hon. SAM RAYBURN,
Speaker of the House of Representatives
Washington, D.C.

My dear Mr. SPEAKER: On January 26, 1959, I wrote you concerning the need for an amendment to the Internal Revenue Code specifying the treatment processes which shall be considered mining for the purpose of computing percentage depletion in the case of minerals. The enclosed draft of proposed legislation would implement the recommendations which I made in that letter for minerals.

During the consideration of this legislation by the Congress we shall continue to work cooperatively with the congressional tax staffs in the development of the legislation, with particular reference to making certain that appropriate treatment is given all affected industries.

It would be appreciated if you would lay the proposed legislation before the House of Representatives. A similar proposal has been submitted to the President of the Senate.

Sincerely yours,

(Signed) ROBERT B. ANDERSON,
Secretary of the Treasury.

Enclosure.

APPENDIX E

SECTION 613(c)

INTERNAL REVENUE CODE OF 1954

(c) DEFINITION OF GROSS INCOME FROM PROPERTY.—For purposes of this section—

(1) GROSS INCOME FROM THE PROPERTY.—The term "gross income from the property" means, in the case of a property other than an oil or gas well, the gross income from mining.

(2) MINING.—The term "mining" includes not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary or his delegate finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills.

(3) EXTRACTION OF THE ORES OR MINERALS FROM THE GROUND.—The term "extraction of the ores or minerals from the ground" includes the extraction by mine owners or operators of ores or minerals from the waste or residue of prior mining. The preceding sentence shall not apply to any such extraction of the mineral or ore by a purchaser of such waste or residue or of the rights to extract ores or minerals therefrom.

(4) ORDINARY TREATMENT PROCESSES.—The term "ordinary treatment processes" includes the following:

(A) In the case of coal—cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment;

(B) in the case of sulfur recovered by the Frasch process—pumping to vats, cooling, breaking, and loading for shipment;

(C) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment;

(D) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores: and

(E) the pulverization of talc, the burning of magnesite, and the sintering and nodulizing of phosphate rock.

APPENDIX F

NATIONAL COAL ASSOCIATION,
Washington, D.C., February 27, 1959.

Hon. FRED C. SCRIBNER, Jr.,
Under Secretary of the Treasury,
Washington, D.C.

DEAR MR. SCRIBNER: The tax committee of the National Coal Association has studied, as thoroughly as practicable within the brief time available, the Treasury Department's suggested legislation concerning the treatment processes which shall be considered mining for the purpose of computing percentage depletion in the case of minerals. On February 10, we asked for 30 minutes to present testimony on this proposed legislation, and on February 24, the committee advised me that such time had been allotted on March 6. Our witness will be Howard E. Lohmann, chairman of our tax committee, and treasurer, Ayrshire Collieries Corp., Indianapolis, Ind.

The Department's draft is comprehensive in its terms, and affects coal as well as brick and cement. That it was clearly the intention to affect some other industries is indicated by the Secretary's letter of January 26, 1959, to the Speaker of the House. It seems reasonable to assume, however, that no substantial effect on the computation of percentage depletion for coal was intended. This inference is drawn from the Secretary's statement, in the letter cited above, that "manufacturers of many other products may obtain depletion allowances based on gross income derived from the sale of finished products [which] * * * can only result in increasing the depletion deduction for all minerals severalfold." Under the present language of section 613 of the 1954 code, I do not believe that the cited court decisions (Merry Bros. Brick and Tile Co. and Dragon Cement Co.) could have the effect of increasing coal depletion "severalfold."

If this assumption is correct, I believe that it would be mutually beneficial to discuss possible drafting changes with representatives of your department prior to your presentation to the Ways and Means Committee March 5, with the purpose of narrowing the areas of possible disagreement. Our specific suggestions are listed on the attached page.

I should also like to point out that the definition of "gross income" is only a part of the percentage depletion equation. An equally important part is the definition of "taxable income," which is conspicuous by its absence from the statute. The National Coal Association believes, and intends to urge, that any amendment of section 613 should take this factor into account and that Congress should provide explicitly for the exclusion of such general deduction items as charitable contributions and bond interest (to cite only two examples) in computing "the taxpayer's taxable income from the property."

I shall be available at any time on March 2 and 3 to discuss the contents of this letter with any person in the Department whom you may see fit to designate. Thank you for your consideration of the matters outlined above.

Sincerely yours,

(S) Richard L. Hirshberg,
RICHARD L. HIRSHBERG,
Assistant Counsel.

Enclosure.

[Attachment to letter of National Coal Association to Hon. Fred C. Scribner, Jr., Under Secretary of the Treasury, Feb. 27, 1959]

OBJECTIONS TO TREASURY DEPARTMENT DRAFT DATED FEBRUARY 12, 1959, CONCERNING THE TREATMENT PROCESSES WHICH SHALL BE CONSIDERED MINING FOR THE PURPOSE OF COMPUTING PERCENTAGE DEPLETION IN THE CASE OF MINERALS (SEC. 613 OF THE 1954 CODE)

(1) The first specific objection which we have is changing the word "includes" to "means" in section 613(c)(2) and deleting the words "the ordinary treatment processes normally applied by mine owners or operators" in the same sentence. A similar change has been effected in section 613(c)(3) by deleting "includes" and substituting a statement that certain processes "shall be considered as 'mining.' "

As a specific example of the effect which this change would have on coal, I cite the process of "blending" of different sizes and qualities of coal which might well be disallowed under the proposed language, but which we believe is clearly allowable under the present law.

(2) The second specific objection to the draft is the requirement that treatment processes applied by the mine owner or operator must be applied to "the minerals or ores extracted from the ground by him" in order to constitute part of the depletion base.

This might have very serious effects on mine owners and operators who do not extract the coal from the ground themselves, but hire an independent contractor to do this portion of the "mining" for them. As you are aware, the exact effect cannot be known until the Supreme Court decides the pending cases on "economic interest" (*Huss* v. *Smith* and *Parsons* v. *Smith*), which are to be argued the week of March 2.

(3) Another provision that might have a considerable effect on coal is the proposed new section 613(c)(4)(B), excluding from the depletion base "any treatment process which follows a process that is not considered a 'mining.'"

For example, if a coal mine operator should add confetti or paint to his coal for advertising purposes and should later perform an allowable "mining" process (such as loading for shipment), the latter process would be disallowed.

(4) There are other specific objections too detailed to recite in this letter but the above are typical of the problems raised—probably unintentionally—by the Department's draft.

APPENDIX G

INTERNAL REVENUE SERVICE TECHNICAL INFORMATION RELEASE JANUARY 8, 1959, (TIR–125)

Internal Revenue Service announced today it is acquiescing in a recent decision of the Tax Court of the United States in the case of United States Potash Co., 29 T.C. 1071.

IRS said the court held that charitable contributions by a mine owner or operator need not be deducted from gross income from the mine in computing the limitation on the percentage depletion allowance.

IRS explained its action means that it will no longer treat charitable contributions as overhead or other expenses which serve to reduce the 50 percent maximum limitation on percentage depletion allowance under section 114(b) of the 1939 code and section 613(a) of the 1954 code.

IRS cautioned, however, that payments to charities which are deductible as business expenses rather than charitable contributions must be deducted in computing the maximum limitation on the depletion allowance where the payments are attributable to the mineral property or to mining processes.

IRS said it has also acquiesced in the Tax Courts decision in *F.H.E. Oil Company* v. *Commissioner*, 3 T.C. 13, a case involving the same issue.

The Revenue Service said steps will be taken to dispose of similar cases, pending administratively or in litigation, in accordance with the decisions of the Tax Court.

APPENDIX H

DRAFT OF SUGGESTED ADDITION TO INTERNAL REVENUE CODE OF 1954 DEFINING "TAXABLE INCOME FROM THE PROPERTY" (NEW SUBSECTION (d) OF SECTION 613)

(d) DEFINITION OF TAXABLE INCOME FROM THE PROPERTY.—As used in this section the term "taxable income from the property" means the gross income from the property (computed without excluding any amount on account of rents or royalties), less the allowable deductions directly attributable to the mineral property upon which the depletion is claimed and the allowable deductions directly attributable to the processes described in paragraph (4) of subsection (c) of this section insofar as they relate to the products of such property, including operating expenses, rents and royalties, development costs properly chargeable to expense, depreciation, property taxes, losses sustained during the taxable year, etc., but excluding any allowance for depletion. Such expenses or deductions shall not include expenses or deductions attributable to, or arising out of expenditures on, other property or assets, irrespective of whether such property or assets are income producing or active. Deductions not attributable to, or arising out of, particular properties, processes or assets, such as general overhead, shall be fairly allocated to all properties, processes and assets whether active or inactive. The term "general overhead" as used herein shall be deemed

to mean the overhead relating to the property but shall exclude deductions and expenses of financial overhead of the taxpayer such as charitable contributions, interest, taxes based on or measured by income, capital stock taxes, and the like.

Mr. HARRISON. Mr. Philip L. Corson, of the National Lime Association, will be the next witness.

Mr. Corson, would you mind stating for the record your name and whom you represent? And in addition, we have seen before this character that appears with you, but we would like to have his name, also.

STATEMENT OF PHILIP L. CORSON, CHAIRMAN, TAX COMMITTEE, NATIONAL LIME ASSOCIATION; ACCOMPANIED BY J. MILTON COOPER, COUNSEL, NATIONAL LIME ASSOCIATION, WASHINGTON, D.C.

Mr. CORSON. My name is Philip L. Corson, and I am accompanied by Mr. J. Milton Cooper, counsel for the National Lime Association.

Mr. HARRISON. At one time the very highly respected chief counsel to this committee.

You have a prepared statement that you would like to read?

Mr. CORSON. Yes, I have.

I am chairman of the board of G. & W. H. Corson, Inc., of Plymouth Meeting, Pa., and I am also chairman of the tax committee of the National Lime Association. The Corson Co. produces lime and limestone products at their quarry located in Plymouth Meeting, near Philadelphia.

I might say at this time that I will be very brief. This statement is short.

As a businessman, I am appreciative of the problems before this committee, particularly those that have been raised in recent years under the percentage depletion statute. Coincidentally, it was on March 5, 1951, that I was last privileged to testify before this committee.

The types of high quality limestone, both calcitic and dolomitic, used for metallurgical or chemical purposes or for producing calcined products are found in relatively few areas and constitute a very small proportion of all limestone deposits.

Under present highly competitive conditions, fuel and labor costs, and greatly increased plant investments required, any limestone deposit which is used for the calcination or burning of lime must be of high chemical purity.

Lime or limestone products are essential in one form or another for almost every industry. Lime is necessary to the Nation's industrial life and is a highly critical war material. For some industries limestone or lime is a basic raw material, such as for the production of pig iron, steel, carbide, caustic soda, soda ash, glass, and refractories. Lime and limestone play a very important part in the construction industry as well as in agriculture. Lime is necessary in the production of aluminum and magnesium. For most of these uses there is no substitute, regardless of price. Lime is necessary for the treatment of water, sewage, and trade wastes.

For every ton of steel manufactured, nearly one-half ton of limestone is required, either in the form of raw limestone, calcined lime-

stone, or "dead burned" dolomitic limestone. The function of the limestone is to remove the silica and alumina by forming a slag, which floats off when the iron is run out of the furnace. Again, when the iron is converted into steel in the open hearth, large quantities of either limestone or lime, or both, are used to further purify the steel.

In addition, the walls and bottoms of the open hearth are protected by dolomitic limestone in either a raw or dead-burned form. For efficient operation steel manufacturers require a pure limestone. Great strides in raising production have been made by using the highest grade limestone, and we believe that the discovery, development, and use of pure limestone deposits must be encouraged since it has so many vital and essential uses.

Large deposits of limestone exist but the amount that is of a grade suitable for metallurgical and chemical use is definitely limited. The deposit must not only be pure, but also extensive in order to warrant the investment needed to install the necessary equipment. In addition to this, it must be close to its market and should be near the surface.

All these requirements reduce the number of available deposits to such an extent that pure limestone, which is necessary to keep our steel and chemical plants running at top production, will probably be in critical supply in the foreseeable future.

Dr. Kenneth K. Landes, head of the Department of Geology at the University of Michigan, in his treatise entitled "Metallurgical Limestone Reserves in the United States," states that:

> Limestone, the rock, is common and abundant in the United States, but metallurgical stone constitutes only a very small part of the total volume of limestone rock. It is a valuable essential and exhaustible mineral resource.

Dr. Landes presented this paper before your committee in 1950 as part of his testimony regarding the scarcity of high quality limestone.

One of the greatest problems from the standpoint of our entire industry, nationwide, has been the lack of uniformity in the application of the law and regulations in connection with "what is gross income from mining."

I believe that the Congress intended that those in the natural resources industries should receive a fair percentage depletion allowance. However, due to the differences in mining situations and the location of various mines, and again more particularly, the arbitrary decisions made by agents in percentage depletion cases, the law has been applied on an unequal basis.

For example, in our association we have had incidents reported where a limestone operator who sold only 2 percent of his production, strictly byproduct stone, was told by the agent that the price of this stone established a field or market price applicable to all the stone calcined by this producer.

In a different collection district, one of our largest producers sold more than 20 percent of his limestone in a competitive market and the agent held that this failed to establish a field or market price for the stone which he burned.

On the other hand, one of our members in an eastern district told me only a few days ago that the internal revenue agent refused to allow him to use the proportionate profits method in arriving at a

price for his stone. This producer was told that the services no longer allowed the proportionate profits method although he sold no stone.

These examples are given to point up the complete lack of uniformity throughout the country in the administration of the percentage depletion laws.

I am informed of another case where the producer had a high-cost mine and the agent held there was no income from mining although the stone, after being burned and made into lime, was sold for a profit. The agent said that the operator was not entitled to percentage depletion.

The Treasury Department has recommended the elimination from the statute of the phrase "commercially marketable mineral product or products," and the substitution of a new definition of mining.

We feel that the new language will give rise to a great many more problems than the present statute, and that the present law is fair to the minerals industry.

In my opinion, if the proposed bill is enacted, it will give rise to much litigation in addition to that presently pending. The term "commercially marketable product" is one that is well understood in the industry.

The proposed bill would exclude "fine pulverization" from ordinary treatment processes while it would allow pulverization of talc. So-called fine pulverization is merely a degree of grinding and in our industry fine grinding is absolutely essential in a great many instances to produce a marketable product.

Our industry only asks that we be treated in the same manner as all other producers of minerals, many of which minerals are in direct competition with limestone, and that within our industry we may be on a competitive basis.

Mr. HARRISON. Does that complete your statement, sir?

Mr. CORSON. I have one other thing I would like to add.

I am also a member of the Dolomitic Refractories Association, which has asked to testify, but relinquished its time since this association fully endorses the statement I have made in behalf of the National Lime Association.

Mr. HARRISON. Are there any questions?

Mr. Herlong?

Mr. HERLONG. This is just for my information.

You state that large deposits of limestone exist, but that of a grade suitable for metallurgical and chemical use is definitely limited. There are large limestone deposits in the central part of our State of Florida. Is that adaptable or suitable for metallurgical or chemical use? Do you know?

Mr. CORSON. Definitely some of it is; I don't know the extent. I know some of the limestone there is not strong enough.

Mr. HERLONG. It is used mostly as a base for highways. That is all, Mr. Chairman. I was just inquiring for my information.

Mr. HARRISON. Mr. Byrnes.

Mr. BYRNES. On page 3 you call our attention to the difference in the application of the present law among various producers or various miners. I would like to have your impression as to why that arises.

You say it is an arbitrary decision made by agents, but it must arise because of different interpretations of the law.

Mr. CORSON. I would imagine that is true. I don't know why we get these situations.

Mr. BYRNES. You have a law, though, that is subject to varying interpretations apparently, according to the court decisions now, and even as related to what the Treasury generally thought the law said and what generally I think Congress thought the law said.

You have some situations now where the courts, at least in my judgment, went way beyond what I thought I was voting for when the matter was before the Congress.

Mr. COOPER. Mr. Byrnes, may I attempt to answer that?

Mr. BYRNES. Yes.

Mr. COOPER. I think it is largely a lack of direction from Washington and not Washington's fault. I think it is the decentralization, and in many of these instances the agents will refuse to send the case to Washington to the natural resources division.

Mr. BYRNES. I realize that that is the situation in part, but you also have great variance now between what the direction of the Treasury is in those cases where they do direct and what the courts are contending the law says, so I do not know how the Congress can ignore that situation and say, "Well, we don't have to do anything," which I gather is your conclusion here—that we just should not change it.

Mr. COOPER. Our greatest problem is finding a price for our stone. As Mr. Corson pointed out in his examples, that is, whether to use the proportionate profits method or the field or market price. I don't think the Treasury would like it, but perhaps a fair way would be for the Congress to say that the taxpayer could elect.

Mr. Lindsay testified at length about the proportionate profits method. The agents are very arbitrary in that regard. They apply it where it is favorable to the Government and detrimental to the taxpayer, but if it is not, then they will get a price somewhere.

That is our problem and that exists. I know it because I have talked to literally 50 or 75 of these producers.

Mr. BYRNES. In other words, you think it might solve some of this, at least to the extent that the marketability test seems to confuse things in some areas by providing alternatives which would be available at the election of the taxpayer.

Mr. COOPER. It is not at all clear which should be used now, and then they have different prices all over the country, as you well know.

It may well be clear if we could elect to use the proportionate profits or a field or market price. I don't think it would cost much revenue to do that either.

Mr. BYRNES. That is all.

Mr. HARRISON. Are there any further questions, gentlemen?

Mr. Alger, of Texas.

Mr. ALGER. Mr. Corson, do you feel that your industry is very definitely a unique situation?

Mr. CORSON. I think that a great many other fields are also plagued with problems.

Mr. ALGER. That are rather unique to their particular fields?

Mr. CORSON. Yes. Ours are unique to our field.

Mr. ALGER. Just taking this as it comes, I recall what Mr. Krause said yesterday afternoon, speaking for the National Crushed Stone

Association, and he made this statement which I would like to read to you and ask for your comment. He said:

> The percentage depletion problems of crushed stone producers cannot be solved by attempts to generally equate the depletable treatment processes of other industries to our basically one-process industry.

The statement I am getting from each industry that testifies is that they feel their problem to be unique to their field and that it cannot be equated.

I want to ask you, can depletion allowance for these diverse industries be equated in a fair formula?

Mr. CORSON. I am afraid I can't answer that.

There are different problems and I think in many cases they could be equated. There are probably other industries in which they could not be equated.

Mr. ALGER. Do you feel that is what we are trying to do?

Mr. CORSON. Do I feel that that is what you are trying to do?

Mr. ALGER. Yes, trying to quate industries and get a fair depletion allowance that will cover them all.

Mr. CORSON. That is what we hope you will do.

Mr. ALGER. Then do you see any merit to the objections, or fears, or the expressions of the Treasury about their difficulties presently in view of your statement now in which you point out there may be even more litigation. You know there is a lot pending right now.

The Treasury is concerned because of this first commercially marketable product matter. Do you not see the trouble the Treasury Department is trying to correct?

Mr. CORSON. I see the trouble they are trying to correct, but I think that in changing the law, you are only bringing more trouble.

Mr. ALGER. Then you would rather have the law stay just as it is?

Mr. CORSON. Yes.

Mr. ALGER. Have you any suggestions other than that that we could use to try to correct it if we think in our effort we should try to correct it.

As I get the gist of your testimony, which I appreciate, it is just leaving it the way it is because the present suggestion is worse than what we now have.

Mr. CORSON. That is right. I agree with that.

Mr. ALGER. However, you have no other constructive suggestion to meet the Treasury's problem?

Mr. COOPER. Mr. Alger, not except the one I made in response to Mr. Byrnes, which is the main problem that is plaguing our industry, finding a price for our stone to apply a percentage depletion, and spell out more clearly whether you take the field or market price or the proportionate profits method. I think that would be very helpful to us.

Mr. ALGER. Thank you, Mr. Chairman.

Mr. HARRISON. Are there any further questions?

Mr. Corson, I would just like to ask you one question.

Directing your attention to the concluding paragraph of your prepared statement for a moment, what minerals are in direct competition with limestone that are treated differently, either under existing law or as proposed in this bill?

Mr. CORSON. For instance, magnesite is allowed calcination in this new proposed law; talc is allowed pulverization, and we are competing with them as fillers. Of course we compete with cement.

Just what will happen in the cement area, we do not know, but we compete with cement and we want to be on an equal basis with them.

Mr. HARRISON. This would put you under a different basis and a discriminatory basis to your industry, is that correct?

Mr. CORSON. Yes, magnesite and talc, and exactly what will happen in the cement area, we don't know, but we don't want to go ahead and find that one of our largest competitors in the construction field gets calcination and we don't.

Mr. HARRISON. Thank you, sir. Thank you very much for your appearance.

Mr. COOPER. Thank you.

(The following letter was received by the committee:)

NATIONAL GYPSUM CO.,
Buffalo, N.Y., March 17, 1959.

Hon. WILBUR D. MILLS,
House Office Building,
Washington, D.C.

DEAR SIR: On March 6, 1959, Mr. Philip L. Corson, chairman of the Board of G. & W. H. Corson, Inc., appeared before your committee on behalf of the National Line Association.

We join Mr. Corson, and the many other persons who appeared before your committee, in asking you to reject the proposed percentage depletion bill which has been requested by the Treasury.

Respectfully yours,

NATIONAL GYPSUM CO.,
D. B. LITTLEWOOD, *Secretary.*

Mr. HARRISON. The next witness is Mr. Robert M. McArthur, Jr.

Mr. McArthur, we are glad to have you and we will be grateful if you will state for the record your name, in what capacity you appear, and who appears with you.

Mr. BOGGS. Mr. Chairman, before this witness proceeds, I would just like to say for the record that the problem that he is presenting was discussed yesterday with the Treasury representatives, who assured the committee that they would work this problem out. Were you in the room at that time?

STATEMENT OF ROBERT M. McARTHUR, JR., ASSISTANT MANAGER, FREEPORT SULPHUR CO., ACCOMPANIED BY D. B. MASON, TECHNICAL DIRECTOR

Mr. MCARTHUR. No, sir; I was not here yesterday.

Mr. BOGGS. You should have been.

Mr. HARRISON. Will you proceed to state your name, Mr. McArthur?

Mr. MCARTHUR. Mr. Chairman and members of the committee, I am Robert M. McArthur, Jr., of New Canaan, Conn. I appear before you today on behalf of Freeport Sulphur Co., by whom I am employed as assistant controller and tax manager.

With me is Mr. D. B. Mason, technical director of the company, who is here to answer any technical questions you might have about the processes mentioned below in this testimony.

We appreciate the opportunity to appear before you and bring to your attention unintended hardships to which our company would be subjected were the Treasury Department's proposals regarding ordinary treatment processes to be enacted in their present form.

Freeport Sulphur Co. is engaged, directly or through subsidiary companies, in the mining of crude sulfur, nicked, cobalt, and potash. It also is engaged in the production of crude oil and gas. The company is the second largest producer of crude sulfur in the world today. Except for a small amount of sulfur recovered from petroleum at the Texas Co.'s Eagle Point refinery in New Jersey, all of Freeport's sulfur is mined by the Frasch hot-water process from deposits in the south Louisiana gulf coast area.

It is the potential impact of the Treasury Department's proposal upon our sulfur depletion deduction that brings me before you now for, in its present form, the proposal would drastically reduce the basis upon which our sulfur depletion deduction has been computed, without question from the Treasury, for over 25 years.

Furthermore, although the proposed law would seriously reduce our percentage depletion deduction, it would not so seriously affect our competitors, whose circumstances differ from ours. In an industry as competitive as sulfur is today, the burden of such a discriminatory treatment would be intolerable.

We are not unmindful of recent cases wherein some of our courts, applying the so-called marketability test of present law, have concluded that percentage depletion is allowable on treatment processes which the Treasury feels are not mining.

We note for the record, however, that none of these cases involved the Frasch process sulfur mining industry. Nor, to our knowledge, have any refund claims been filed by any Frasch sulfur producers on the basis of these cases. Notwithstanding this, we are willing to join with the American Mining Congress in not opposing the Treasury Department's basic position that marketabality should be eliminated as a test in determining what processes constitute mining.

We take this position for reasons heretofore presented to you by the American Mining Congress which, in the interest of time, I will not here restate.

However, while we can accept the propriety of the Treasury's desire to prevent unwarranted extensions of the depletion base, we see no justification for the imposition of penalties upon those, such as ourselves with whom the Treasury presumably has no quarrel. Similarly, we see no justification for the upsetting of administrative practices long accepted by the Internal Revenue Service without controversy.

Actually, we do understand, from preliminary discussions we have had with some of the Treasury Department representatives, that no serious change in the calculation of the sulfur depletion deduction was intended by the drafters of the proposed bill. Indeed, we believe that the Department generally is sympathetic to our problems, which were unknown to them when their draft was composed. Notwithstanding this, we have not been able, in the short time available, to secure any commitment from the Department regarding these questions.

We wish, therefore, since this is a matter of the greatest importance to us, to present our case for the record and officially to request certain changes in the proposed legislation.

In its draft the Treasury has sought to achieve its objectives by:

1. Removing the marketability test as a criterion for determining what are allowable mining processes.
2. Listing all of the approved and nonapproved mining processes, and
3. Disallowing any process which follows an unnamed or unapproved process. This is section 613(c)(4)(B) of the Treasury proposal, sometimes referred to as the "sudden death" clause, and I understand by the Treasury as the cutoff clause.

The proposed draft lists as approved processes for Frasch process sulfur miners only the following four processes:

1. Pumping to vats.
2. Cooling.
3. Breaking.
4. Loading for shipment.

No other processes are named or approved. Should any unnamed or unapproved processes take place, therefore, automatic cutoff would occur by operation of the "sudden death" provisions of proposed section 613(c)(4)(B).

While there may be reason for adoption of this new and very severe limitation, or a variation of it, to prevent abuses in a few cases, we believe that no such need exists with respect to the Frasch process sulfur mining industry and we urge removal of proposed section 613(c)(4)(B) except where clear need for it can be demonstrated.

As we shall explain in a moment, when coupled with omissions on which we shall comment below, the effect of the section is to ignore 25 years of our company's sulfur mining history in Louisiana and actually to penalize us for achieving certain important technological breakthroughs which have made it possible for us to use sea water for the mining process, and thus to open up important new sulfur reserves in the Louisiana gulf coast area.

Although the practicability of the Frasch process as a means of mining sulfur was first demonstrated in western Louisiana, most of the early sulfur production came from deposits in Texas.

Freeport Sulfur Co., oldest of the present Frasch-process sulfur producers, was organized in 1912 to mine sulfur from the Bryan Mound deposit located in Brazoria County, Tex. In 1923 production was secured from Hoskins Mound, near the town of Freeport, Tex.

The eventual depletion of even these fine deposits had to be anticipated, however, and Freeport continued to seek new sources of supply. Ultimately these were found in the bayou country of south Louisiana, and, most recently, beneath the floor of the Gulf of Mexico itself. Freeport's mine at Bryan Mound became depleted in 1935 and the mine at Hoskins Mound in 1955; today all of the company's Frasch-process sulfur is secured from its Louisiana mines.

Sulfur mined from deposits in Texas has almost invariably been quite bright yellow in color and quite clean, that is, generally containing less than 0.05 percent carbonaceous-waste matter. Sulfur mined from the deposits in Louisiana, on the other hand, generally has a

dark brown color derived from the presence of carbonaceous matter naturally present in the formation where sulfur is found.

In the course of the hot-water Frasch mining process, this contaminating carbonaceous waste is melted out of the host limestone formation whereupon it mixes with, and discolors, the crude sulfur which comes out of the ground. The carbon content of this dark sulfur ranges from 0.20 percent to 0.60 percent.

Since carbonaceous contamination in concentrations above 0.05 percent not only darkens the color of the sulfur, but also interferes substantially with its greatest use, the manufacture of sulfuric acid, the carbon waste in excess of 0.05 percent must be removed by cleaning.

Still another difficulty was encountered in Louisiana which had not been present in Texas, for the projection of our mining operations into the low-lying salt water areas of the Gulf Coast made it increasingly difficult for us to obtain the large quantities of fresh water normally utilized in the Frasch-sulfur mining process. Consequently, it has been desirable to utilize sea, or brackish, water for mining purposes and to develop methods by which such water can be heated without incurring the expected difficulties of corrosion and scale deposition.

Freeport Sulfur Co. has succeeded in this development and has secured patents on its sea-water heating processes. As a result, several of Freeport's deposits are, or will be, mined by use of salt water. All other Frasch producers continue to use fresh water for their mining process.

A consequence of mining sulfur with brackish or sea water is that the extracted sulfur sometimes contains small, but detrimental, quantities of the salt originally contained in the hot water used for mining. The presence of this salt is objectionable for several reasons. Paramount among these is the fact that the combination of sulfur with even a very small amount of salt is highly corrosive and extremely harmful to equipment with which it comes in contact. The presence of salt causes poisoning of the catalyst used in sulfuric-acid plants as well as corrosion of the plants and equipment used to contain sulfuric acid. It is therefore essential to process for salt removal all sulfur mixed with salt water.

Freeport is the only Frasch-process company today which can successfully use salt water for mining purposes. Substantially it is the only U.S. producer which has to clean carbon from its sulfur. The smallest domestic producer filters part of its product for carbon removal.

In spite of the fact that Freeport is put to considerable expense to clean its Louisiana sulfur, the crude sulfur it now secures is not in any respect better than it used to secure from its Texas mines. Even with cleaning, Freeport does not get any more for its crude sulfur than its competitors, who are not required to clean.

By way of illustration, I have here a sample of the product presently being secured, without cleaning, by our principal competitor whose mines are in Texas. Here also is a sample of the sulfur that we used to extract from our Hoskins Mound mine in Texas, which became depleted in 1955.

You will notice the bright yellow color of both of these samples.

Here, on the other hand, is a sample taken from one of our present-day Louisiana mines.

You will note that this latter sample is dark brown in color, reflecting the discoloration caused by presence of carbonaceous waste. All of the time and money we have spent in the cleaning of sulfur is merely to make this Louisiana product as bright and as clean as the sulfur we used to get in Texas, and as clean as the product produced without cleaning by our competitors.

Freeport has been cleaning carbonaceous waste material from Louisiana sulfur since its Louisiana production commenced over 25 years ago. It has been cleaning salt from sulfur mined with salt since 1942.

No question heretofore has been raised by the Treasury Department regarding these mining processes, although they are not specifically enumerated in the present statute—because the statute states that the term "ordinary treatment processes" for sulfur mined by the Frasch process includes pumping to vats, cooling, breaking and loading for shipment, thus leaving room for recognition of other common mining processes such as cleaning.

These long-approved cleaning processes are not recognized for sulfur, however, under the more restrictive language of the Treasury proposal before your committee. Even worse, through operation of the "sudden death" provisions above referred to—proposed section 613(c)(4)(B), no processes which occur after cleaning would be allowable.

Since sulfur is cleaned before it is vatted, the effect of the "sudden death" clause, operating in conjunction with the nonstatement of cleaning as an ordinary treatment process, would be to eliminate, for a substantial portion of our sulfur production, all of the ordinary treatment processes prescribed in the statute for Frasch-processed sulfur.

Our competitors, who do not have to clean their sulfur, would not be so harshly treated.

To insure that this severely discriminatory, and we hope unintended, result does not occur, we ask your committee to name cleaning as an ordinary treatment process for sulfur mined by the Frasch process.

For the record, we attach to this statement an appendix which sets forth a description of the processes by which Freeport cleans its sulfur.

Our third request is for approval of an agglomerating process, not named in the Treasury's draft, which for several years we have been developing for the purpose of preventing dust loss and thus making it possible to sell and ship a part of our production which otherwise would blow away.

Sulfur is solidified and stored in open outdoor vats under conditions which result in its being friable. While this storage has the advantage of permitting the solid sulfur to be dug directly out of the vats with power shovels without the necessity of first blasting it with explosives, an appreciable portion of the sulfur is reduced to powder in the course of normal handling. This powdered sulfur is especially subject to loss, dust explosion and moisture absorption.

To reduce the quantity of dust, coarse lumps of sulfur are separated from the finer material by sifting on a coarse screen and the fines are then processed onto agglomerates by mixing them with liquid sulfur

in a simple agglomeration process more fully described in an attached appendix.

Proposed section 613(c)(3)(B) of the Treasury bill provides that in the case of all minerals or ores except coal and sulfur there shall be allowed as ordinary treatment processes "any additional process, if necessary, to bring the mineral or ore to form and condition suitable for shipment." The section further provides that:

> The processes referred to are those processes which are necessary to bring the mineral or ore to the physical form and condition in which it is capable of being transported as distinguished from those processes applied to make the mineral or ore salable.

Since the agglomeration process applied to our crude sulfur is performed solely to bring the crude sulfur into form and condition suitable for shipment and does not add anything to the price we receive for it, we respectfully request that your committee add agglomeration to the listing of approved processes for Frasch-produced sulfur or that you make applicable to sulfur provisions equivalent to section 613(c)(3)(C)(iv) of the Treasury proposal.

For some years our company has bagged sulfur for a few of its customers. The cost of this bagging has not been claimed as a mining process but the cost of loading the bagged sulfur for shipment has been claimed and allowed as an ordinary treatment process. Since, under the Treasury proposal, bagging is not listed as an acceptable process, loading of the bagged sulfur for shipment would be eliminated by operation of the "sudden death" clause previously mentioned.

From the language of proposed section 613(c)(3)(C)(v), which does not apply to sulfur, it appears that the intent of the statute is to permit loading for shipment so long as such loading does not include the cost of packaging or the cost of containers, bags and similar items. We ask that equivalent treatment be granted to sulfur, that is, that the cost of loading bagged sulfur, but not the cost of the bags nor the cost of putting sulfur into the bags, be allowed as an ordinary treatment process for us as it has been in the past.

Over the years the business of mining sulfur has changed considerably and the production of crude sulfur has increased substantially. Our company has played an important part in this progress and we constantly are seeking new and better techniques for mining sulfur. We have good reason to believe that we will meet with a fair share of success in our efforts and that we will develop new processes as we go along.

We are, therefore, very much disturbed over the rigidity of the Treasury's proposals. To us these seem unduly restrictive for reasons above mentioned and also because for all minerals they inhibit and penalize technological progress which is so vital to our country today. It is especially distressing to us that the Treasury proposal restricts sulfur even more in this respect than other minerals.

Since, to our knowledge, sulfur producers have not been involved in serious controversies with the Treasury on any of these matters, we recognize that these restrictions are very likely unintentional and that we are, at the least, entitled to the same flexibility as that provided for other minerals.

We strongly concur, therefore, in the request previously made by the American Mining Congress that you make applicable to all minerals

and ores a provision that mining includes not only the listed permissible processes but also the processes necessary, appropriate, or incidental thereto even though such processes might otherwise be on the prohibited list.

Additionally, if we are to avoid penalizing the technological improvement and progress which our country needs so much, we urge that you amend the proposed bill to provide that mining shall include processes or combinations of processes which, as to the particular mineral involved, produce substantially equivalent results to the processes now considered mining.

We believe that this provision should be made applicable to all ores and minerals and urge you to make clear that the substantially equivalent test refers to results rather than to method.

Mr. Chairman, we appreciate very much the attention you and the committee have given to our remarks today and we hope that our requests may receive your favorable consideration. We shall, of course, be most happy to confer on these questions with representatives of your staffs and those of the Treasury Department, as you may feel appropriate.

That is the end of our presentation and Mr. Mason and I will try to answer any questions that you might have.

Mr. HARRISON. Mr. Boggs.

Mr. BOGGS. Mr. Chairman, first I would like to congratulate Mr. McArthur for bringing this problem to the attention of the committee, and also in his statement, which of course is a very clear statement and one that points out the problem.

On yesterday when the Treasury people were here, Mr. Lindsay and others, I asked them several questions about this very problem, this discriminatory result which would be achieved if the draft language were adopted. They assured the committee that they would correct that problem, which is very obvious, as you have explained in your testimony.

I hope that will be done.

Mr. MCARTHUR. Thank you, Mr. Boggs. We hope so, too.

Mr. BOGGS. Thank you, Mr. Chairman. That is all.

Mr. HARRISON. Are there any further questions?

If not, we thank you very much for your appearance and the information you have given the committee.

The next witness to appear before the committee is Mr. William J. Kenney.

Mr. Kenney, we are very happy to have you. Will you please identify yourself for the record.

STATEMENT OF WILLIAM J. KENNEY, GENERAL COUNSEL OF THE REFRACTORIES INSTITUTE

Mr. KENNEY. Thank you.

I am William J. Kenney, general counsel of the Refractories Institute, a national association of 85 refractory manufacturers producing approximately 90 percent of the total refractories tonnage in the United States. I appear on behalf of the membership of the entire refractories industry.

Refractories are nonmetallic products designed for use in high temperatures and are made from a wide variety of raw materials of

which refractory clay and quartzite and silica-quartzite pebble are those used in largest quantities. They are used in the iron, steel, aluminum, copper, nickel, lead, zinc, pottery, chemical, paper, portland cement, glass and petroleum and other industries and in steam power and heating plants.

Refractory clays of various types and qualities are processed into clay and high alumina refractories. The raw materials used for manufacture of clay refractories are flint clay, including diaspore and burley clays, kaolin, and bond or plastic clay. Silica refractories are produced from quartzite of high purity.

Because of the widespread location of these raw materials, mines and production facilities are found spread through 27 States. The plants are found in rural locations:

Alabama, 5 plants; Arkansas, 2 plants; California, 9 plants; Colorado, 5 plants; Connecticut, 2 plants; Georgia, 5 plants; Idaho, 1 plant; Illinois, 18 plants; Indiana, 4 plants; Kansas, 1 plant; Kentucky, 9 plants; Maryland, 7 plants; Michigan, 3 plants; Missouri, 19 plants; New Jersey, 11 plants; New York, 5 plants; North Carolina, 2 plants; Ohio, 63 plants; Pennsylvania, 89 plants; South Carolina, 4 plants; Tennessee, 3 plants; Texas, 9 plants; Utah, 3 plants; Vermont, 1 plant; Washington, 1 plant; West Virginia, 4 plants; Wisconsin, 1 plant.

At the outset of percentage depletion in 1951, the members of the refractories industry adopted a reasonable approach to the percentage depletion deduction and in filing their income tax returns generally filed on the basis of the value of crushed and ground refractory clay and quartzite.

The industry in general sells a portion of its product, approximately 7 to 10 percent, in crushed and ground form for use as mortar in association with the burned refractory shapes. Members of the refractories industry have for many years sold this product at definite prices and have carried such items on published price lists. The value used for crushed and ground refractory clay and quartzite in such tax returns for computing the percentage depletion deduction was the price thus established.

The Internal Revenue Service, in examining the income tax returns of members of the refractories industry has taken the position that such sales of crushed and ground product are so insignificant as not to establish a market price.

The Internal Revenue Service has attempted to create a fictitious market price for crushed and ground refractory clap and quartzite by use of the proportionate cost method or by arbitrary valuation. The values thus arrived at have borne no relation to actual sales and have varied in amount from taxpayer to taxpayer. The result is that the members of the refractories industry in general have open and undetermined their income tax returns for the 8 years 1951–58, inclusive.

This situation has imposed an intolerable burden upon the industry and has created a situation in which no certainty as to tax liability or ultimate obligation is possible. Under these circumstances it is little wonder that some members of the refractories industry have filed claims based upon "end product" depletion, as did the structural brick industry, and cement industry and many other industries.

The apparent purpose of the amendments proposed by the Treasury Department to section 613 of the Internal Revenue Code of 1954, so

far as the refractories industry is concerned, is to establish as a definite cutoff point crushed and ground refractory clay and quartzite. In general, the proposed language achieves this result so far as a provision designed to cover many industries can be expected to achieve.

The refractories industry would be satisfied with a percentage depletion deduction computed upon the value of refractory clay and quartzite at the end of the crushing and grinding processes, provided, however, that a definite method for arriving at the value of the product as such state is also established. The proposed Treasury amendment does not even purport to solve this very basic problem, and the refractories industry is opposed to its adoption unless the problem of valuation is simultaneously solved.

We assume that the Treasury Department proposes to solve the problem of value as they have attempted to solve it in the past, in terms of the proportionate cost formula as provided in the regulations under the 1939 code, and under the proposed regulations under the 1954 code.

The proportionate cost method involves the establishment of the ratio which the cost of processes deemed to be mining bears to the total of mining and subsequent processing costs and the application of such percentage to the selling price of the finished product.

The refractories industry has found through experience that such a method reaches a wholly unrealistic value for the crushed and ground refractory clay and quartzite. The value so reached is, of course, dependent upon the relationship of each taxpayer's mining costs to his total costs. The ratio depends upon and will be varied by the nature and the quality of the mineral deposits and the method of mining. The ratio is also affected by factors which have no relevancy to the mining operation itself, such as:

1. A modern manufacturing plant with low total manufacturing costs will receive a greater value for crushed and ground product than a neighboring competing plant with less efficient manufacturing processes although the mineral deposits are identical and adjacent and the extraction costs are identical.

2. The percentage of plant capacity operated by taxpayer during particular year will either raise or lower the ratio and thus affect the value of the crushed and ground product for that year.

The result is that under the proportionate cost method and in actual practice each taxpayer receives a different market value for its crushed and ground product although the products sold by his competitors are identical. This is wholly unsustainable on any logical basis.

The proportionate cost method is so inaccurate and unrealistic that the courts have generally refused to apply it.

The refractories industry in view of its past experience asserts that the proposed Treasury amendment in its present form can give no certainty as to the percentage depletion deduction of any member of the industry. The refractories industry has had a wholly unsatisfactory experience in voluntary cooperation in an attempt to arrive at the identical result proposed by the Treasury's amendment and is convinced that no valuable result or certainty of tax can be reached without a simultaneous solution of the value of the mineral product problem.

Generally, the refractories industry as a whole has historically sold approximately 7 to 10 percent of its total annual tonnage in crushed

and ground form. We believe that this is the only possible indicium of the value of crushed and ground refractory clay and quartzite and therefore suggest the following provisions be included in any amendment to section 613(C) of the Revenue Code of 1954:

DETERMINATION OF GROSS INCOME IN CERTAIN CASES

In the case of clay, quartzite and other minerals used or sold for use for purposes dependent upon their refractory properties, the gross income from the property shall be determined by reference to selling prices received for such mineral products of the same grade and quality at the end of the treatment processes considered as mining and, in the absence of sale, by reference to prices and quotations published by the taxpayer or in the industry for such mineral products of the same grade and quality at the end of the treatment processes considered as mining, provided that the ratio of such prices and quotations to prices and quotations for manufactured end products shall be limited to the ratio which existed immediately prior to the date or dates upon which percentage depletion at 15 percent was first accorded these minerals.

The refractories industry is unalterably opposed to the Treasury Department's proposed amendment to section 613 of the Internal Revenue Code of 1954 in its present form as representing a solution of only a portion of the problem confronting the refractory industry. The primary problem is valuation of the proposed cutoff point. Until this is squarely recognized and met, no amendment can be said to meet the minimum requirements of certainty and definiteness of taxation.

Thank you very much.

Mr. FRAZIER (presiding). Are there any questions?

We thank you very much for appearing before the committee and giving us the benefit of your views on this proposed legislation.

That completes the hearing this morning. We will stand adjourned until 10 o'clock Monday morning.

(Thereupon at 12:05 p.m., the committee recessed, to reconvene at 10 a.m., Monday, March 9, 1959.)

MINERAL TREATMENT PROCESSES FOR PERCENTAGE DEPLETION PURPOSES

MONDAY, MARCH 9, 1959

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met at 10 a.m., pursuant to recess, in the committee room, New House Office Building, Hon. Wilbur D. Mills (chairman) presiding.

The CHAIRMAN. The committee will please come to order.

The Chair observes that our colleague from Louisville, Mr. Burke, is in the room at the witness table and would like to introduce our first witness this morning.

Mr. Burke, you are recognized, sir.

STATEMENT OF REPRESENTATIVE FRANK W. BURKE, OF KENTUCKY

Mr. BURKE. Thank you, Mr. Chairman.

Without presuming to comment on this pending legislation, I am honored to present to the committee Mr. Boyce Martin, of Louisville, who is the president of the Louisville Cement Co. and who, I understand, will present to the committee the views of a great number of businesses in the limestone and cement industry. Mr. Martin has had a very distinguished career, not only in business but in the field of education, and I feel sure that his remarks will be helpful to the committee.

The CHAIRMAN. We thank you, Mr. Burke.

Mr. Martin, you are recognized, sir.

STATEMENT OF BOYCE F. MARTIN, PRESIDENT, LOUISVILLE CEMENT CO.; ACCOMPANIED BY HARRY MITCHELL, CORPORATION COUNSEL, LEHIGH PORTLAND CEMENT CO.; AND JOHN T. SAPIENZA, ATTORNEY AT LAW, WASHINGTON, D.C.

Mr. MARTIN. Thank you, Mr. Chairman.

I would like to present my colleagues. On my right, Mr. Harry Mitchell, who is the corporation counsel of the Lehigh Portland Cement Co., Allentown, Pa., and on my left, John T. Sapienza, our counsel for this appearance.

Mr. Chairman, I would apreciate it if this entire brief could be incorporated into the record, including the appendixes and the footnotes.

The CHAIRMAN. Without objection, the entire brief will be included in the record, Mr. Martin.

Mr. MARTIN. I am Boyce F. Martin, of Louisville, Ky. I am president of the Louisville Cement Co. I am appearing on behalf of the 38

cement companies listed in appendix A to this statement. These companies collectively represent slightly more than 70 percent of the capacity of the entire cement industry in the country.

The Treasury has proposed that section 613 of the Internal Revenue Code be revised by deleting the commercially marketable mineral products test and substituting an unworkable "mining-manufacturing" rule in its place. We appear in opposition to that proposal. Briefly, our reasons are as follows:

1. The Treasury proposal is obscure in meaning in that it contains numerous provisions that are unclear in their application to the cement industry.

2. It is discriminatory:

(*a*) Between cement producers who are in competition with each other, and

(*b*) Between the cement industry and other industries using comparable treatment processes.

3. It is based on a fallacious concept—the view that all of the treatment processes in the Nation's more than 50 extractive industries can be classified, fairly and accurately, between those that are mining and those that are manufacturing. This view will lead to enormous problems in administration and to endless controversy between taxpayers and the Internal Revenue Service in the computation of the percentage depletion allowance.

4. It is premised on an assertion concerning a revenue loss which is incorrectly and misleadingly described, in that:

(*a*) Whether any significant loss will result at all is dependent on the outcome of litigation now pending in the courts; and

(*b*) It is indefensible to use the word "loss" to describe a situation in which the Treasury Department is required to pay back taxes which the courts have held it had no authority to collect under the internal revenue laws.

Our recommendation is that you retain the commercially marketable mineral products rule that has been part of the percentage depletion section of the internal revenue laws since 1932. This test is simple to understand and easy to administer. It will present no problem if the Treasury will accept its plain meaning.

There is no justification for replacing it with a formula based on a differentiation between mining and manufacturing which will inevitably lead to the controversies and discrimination that will be outlined.

Cement is the binding agent which, when mixed with sand, stone, or other aggregates and water, produces concrete. It is one of the Nation's basic construction materials.

Cement production involves the extraction, crushing, milling, and burning of certain types of natural deposits—usually limestone—to form a clinker.

At this point, Mr. Chairman, I would like to correct a statement made on March 5 by the Treasury's representative, Mr. McGinnis, when he said that any limestone could be used to produce cement. This is not correct. Cement-grade limestone must meet very strict chemical composition specifications. These, usually, are not met by limestones suitable for agricultural limestone or crushed stone nor even by many chemical- and metallurgical-grade limestones. The severe limitations imposed by the strict specifications, that is, Fed-

eral, State, and others, on the magnesia content, alkali, phosphorus, and so forth make cement-grade limestones, quite rare among the larger number of calcareous stone deposits in the United States.

A limestone deposit which meets these strict chemical requirements for cement, which contains enough uniform quality tonnage to support a cement plant for at least 50 years, and which is near a market area, is a very valuable and unique property.

After cooling, the clinker is ground into fine particles. The treatment process normally applied in the cement industry to produce cement is as follows:

1. The raw material extracted from the ground either through (*a*) mining by the open pit method, or (*b*) underground mining.
2. The raw material is crushed and ground to the proper fineness for burning in the kiln.
3. The raw material is introduced into the upper end of an inclined rotary kiln, and as it descends it is burned to a clinker.
4. The clinker is ground to the fineness of cement. A small amount of gypsum is interground with the clinker to control the setting time of finished cement. Depending on the nature of the raw material, small quantities of argillaceous material, usually clay or shale, may also be added during the raw processing to provide the ingredients of alumina and silica which the finished cement must contain.
5. The cement is then placed in storage silos, from which it is eventually loaded in railroad cars or trucks, either in bags or in bulk, for shipment to purchasers.

There are approximately 50 cement companies in the United States. They operate 162 cement mills. These plants are located generally throughout the country. Only 11 States contain no cement mill.

Cement is one of the country's cheapest building materials. The average price of a barrel—a barrel of cement equals 376 pounds—of cement in the United States is about $3.50 at the mill, or less than a penny a pound.

The commercially marketable mineral products test is now found in section 613(c) of the Internal Revenue Code of 1954. It is briefly and simply worded. It says that: "The gross income from the property"—the dollar base for percentage depletion—is gross income from mining and that the term "mining" includes:

> * * * not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products * * *

This rule is clear and unambiguous. Its legislative history shows that Congress meant exactly what it said in the plain language of the statute—namely, that the "gross income from the property" to which the depletion rate is to be applied must include the gross income from all processes which mine owners or operators normally apply in order to obtain a product for which a commercial market exists.

In his statement to this committee on March 5, 1959, in support of the Treasury's bill, Mr. David A. Lindsay, Assistant to the Secretary of the Treasury, made certain comments regarding the legislative history of the commercially marketable mineral products test. Although we have no doubt that they were made in good faith, those comments are erroneous in important respects. It is essential that the correct description of the history of this rule be brought to the

attention of the committee and Congress. To that end, there is set forth in appendix D of this statement a memoradum discussing in detail the legislative history of section 613 of the Internal Revenue Code of 1954, where the commercially marketable mineral products rule is now contained. The legislative history clearly shows two things:

1. Congress has consistently stated that the commercially marketable mineral products rule shall be the method under which the dollar base for percentage depletion shall be obtained; and

2. The Treasury has stubbornly refused to accept this test.

The Treasury's attitude was first brought to the attention of Congress in 1942. Congress considered remedial legislation. Finally, however, in reliance upon a representation of the Treasury that its procedures would be adjusted to adhere to the commercially marketable mineral products test, Congress decided to allow the correction to be handled administratively.

Nevertheless, in the very next year, 1943, Congress was told that the Treasury was still attempting to exclude certain processes from the percentage depletion computation despite the fact that they were necessary to reach a marketable product. Consequently, Congress concluded that amendatory legislation was required.

In the Revenue Act of 1943 Congress, adopting language which it stated was declaratory of its original intent, inserted the following statutory definition of the term "gross income from the property" in order to remove all doubt regarding the applicability of the commercially marketable mineral products test:

> **The term "mining," as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products * * *. (Revenue Act of 1943, sec. 124.)**

Although this statutory language was very clear, the report of the Senate Finance Committee was even more explicit on the point. It said:

> **The purpose of the provision is to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product should be considered as part of the mining operation * * *. (S. Rept. 627, 78th Cong., 1st sess., p. 23, 1944 C.B. 991.)**

Nevertheless, the Treasury did not yield to the mandate of Congress. When the Revenue Act of 1951 added a number of new minerals to the list of those entitled to percentage depletion, including, for the first time, those used in the production of cement, the Treasury again attacked the commercially marketable mineral products rule. It wrote a mining-manufacturing theory into the regulations governing the computation of the allowance for certain of those minerals, including those used by the cement industry. This theory apparently represented the formalization of a point of view that had been basic to the Treasury's thinking in its pre-1943 efforts to frustrate the commercially marketable mineral products test.

Objection to the reintroduction of this congressionally-disapproved doctrine soon appeared. A rash of litigation broke out. The Treasury's regulation was challenged in the courts by taxpayers in several industries. They argued that the regulation was invalid, since it was in clear conflict with the commercially marketable mineral products

test. The litigation was strongly resisted by the goverment. It culminated in a complete victory for the taxpayers.

The courts of appeals for four Federal circuits, without a single dissent, unanimously agreed that the mining-manufacturing argument of the Treasury was not compatible with the plain meaning of the statute and that the Treasury's regulation was invalid.

In October of 1957 the Supreme Court announced that it would not review the issue, thus leaving undisturbed the decision of the courts of appeals: *United States* v. *Dragon Cement Company, Inc.*, 244 F. 2d 513 (1st Cir. 1957), cert. den., 335 U.S. 833 (1957); *United States* v. *Merry Brothers Brick & Tile Company et al.*, 242 F. 2d 708 (5th Cir. 1957), cert. den., 355 U.S. 824 (1957); *United States* v. *Cherokee Brick & Tile Co.*, 218 F. 2d 424 (5th Cir. 1955); *United States* v. *Sapulpa Brick & Tile Corp.*, 239 F. 2d 694 (10th Cir. 1956); *Townsend* v. *The Hitchcock Corp.*, 232 F. 2d 444 (4th Cir. 1956).

With this bill, the Treasury is thus making its third major attack on the commercially marketable mineral products test in 27 years.

A reprint of section 613 of the Code as it will be read if the bill is adopted is set forth at appendix B.

The bill is premised on the assumption that one can examine the wide range of operations applied in a variety of industries in the processing of natural deposits and can say with accuracy that some of these processes are mining and that others are nonmining—that is, manufacturing. A depletion allowance will be permitted with respect to those operations which are in the former category. The allowance will be denied to the others.

As I mentioned above, the defects of the bill fall into three main categories:

(*a*) It is obscure and confusing in meaning.

(*b*) It is discriminatory between taxpayers.

(*c*) It is based on a fallacious and unrealistic concept—the mining-manufacturing theory—that will lead to enormous problems in administration and to endless controversy between the Internal Revenue Service and taxpayers.

In sum, there can be no better proof of the futility of trying to write percentage depletion legislation on the mining-manufacturing theory than the defective bill which the Treasury has submitted.

The bill attempts to distinguish between mining and manufacturing processes by enumerating a number of processes. Some of these are designated as applicable to specific industries. Others are presumably common to mineral processing. All of these processes are then arbitrarily classified as either mining or not mining, that is, manufacturing. No general rule is given to control the classification, beyond the suggestion that a process is mining if it is necessary to bring a mineral or ore to "form and condition suitable for shipment". These words are intended to cover only processes necessary to bring the mineral or ore to the physical form and condition in which "it is capable of being transported" as distinguished from processes applied to make the mineral or ore salable. We cannot conceive of any process which would make the mineral or ore capable of being transported and does not also make the mineral or ore more salable.

At this point I should mention that in its presentation last week the Treasury indicated that it will have to add a third category of neutral

processes. The fact that a third category is required is further proof that the Treasury's mining-manufacturing theory is unsound.

A glance at the bill will quickly reveal the confusion which it generates.

For example, in the case of crude minerals or ores—crushing, grinding, sorting, screening, washing and drying, together with certain kinds of beneficiation and additional processes which bring the raw materials to condition suitable for shipment, including loading for shipment, are all considered to be mining processes. The pulverization of talc, the burning of magnesite, the furnacing of quicksilver ores, and the sintering and nodulizing of phosphate rock are also mining processes. However, fine pulverization, blending with other materials, treatment effecting a chemical change, thermal action and calcining are all labeled manufacturing processes.

What the bill will mean to the cement industry, in terms of "gross income from the property," is unclear.

Prior to the introduction of raw material into the kilns, cement producers may mix clay or shale with linestone. Is this "blending with other materials" and thus a manufacturing operation?

The bill also says that fine pulverization is a manufacturing process. What does fine pulverization mean?

Cement production typically involves raw grinding immediately following the primary and secondary crushing. In this operation, the raw material is reduced from approximately 2 inches in diameter to suitable size for burning in the kiln, many particles of which are fine enough to pass through a sieve having 200 openings to an inch. Is this "fine pulverization" within the meaning of the bill?

If it is the intent of the bill to classify the cement industry's mixing of materials and raw grinding as manufacturing steps, the bill will reduce the dollar base for the cement industry's percentage depletion substantially below what it was under the regulations applicable to prior years.

The Treasury's statement to the Ways and Means Committee on March 5, 1959, asserts it did not intend to cut back on such processes, but concedes it may have inadvertently done so.

The bill is replete with internal inconsistencies that represent unjustifiable discriminations between different industries and between producers in the same industry.

As noted, the bill specifically states that the burning of magnesite, the furnacing of quicksilver ores, and the sintering and nodulizing of phosphate rock are mining processes. However, the bill provides elsewhere that thermal action is a manufacturing process.

Under this latter clause, the kiln process in the cement industry will fall in the manufacturing category. All of the former processes nevertheless also represent thermal action.

Is there any logical basis which justifies the exclusion from the mining category of a thermal action process—burning in a rotary kiln—in the cement industry, and the inclusion of essentially identical processes—burning, furnacing, and nodulizing in rotary kilns—in the magnesite, quicksilver, and phosphate rock industries?

Furthermore, under the bill any "treatment effecting a chemical change" must be regarded as manufacturing and the kiln process in the production of cement effects such a change. However, chemical changes are effected by such processes as cyanidation, leaching, pre-

cipitation and the furnacing of quicksilver ores carried on in a rotary kiln the same as cement. All of these processes are regarded as mining under the bill, despite the chemical changes they bring about.

Is there any justification for permitting processes to be deemed mining when chemical changes are caused by some methods, such as those just listed, and not to be deemed mining when caused by other methods, such as the kiln operation in cement production?

The pulverization of talc is listed as a mining operation. Yet any fine pulverization is stated to be manufacturing. In talc pulverization the material is ground so finely that 99 percent of it will pass through a sieve having 325 openings per linear inch. Finish grinding in the cement industry does not grind this finely. Why, therefore, is finish grinding in the cement industry a manufacturing process?

When asked on March 5, 1959, to justify these discriminatory provisions, the Treasury representatives replied that they were in the present law, thus implying that Congress was responsible for the discrimination. They overlooked the obvious fact that pulverization of talc, burning of magnesite, furnacing of quicksilver ores, sintering and nodulizing of phosphate rock and the various treatments effecting a chemical change are entirely appropriate and nondiscriminatory processes for inclusion in the statute so long as it is based on the commercially marketable mineral products test. If this test is to be repealed, there is no rational basis for treating such processes as mining in some industries and manufacturing in others.

Even if a formula could be devised to effect, as of today, an equitable and sound segregation of mining processes from manufacturing processes, technological developments would make the rule obsolete in a relatively short time.

Technological change is a basic characterization of American industry. A law premised, as is this bill, on the assumption that certain processes are immutably fixed in a production line forevermore will require continual amendment if it is to operate properly and uniformly in the future.

Illustrations of this have been given by others.

An example in the cement industry is the so-called preheater technique introduced several years ago in the American cement industry, based on developments in Europe. Approximately 10 plants in the United States have already adopted this technique.

The process involves a preliminary heating and drying of the raw material, sometimes accompanied by a nodulizing operation, before it enters the kiln. Is this manufacturing, that is, thermal action, or is it mining? In some cases the preheater is physically attached to the kiln. If the first type of preheater operation is a mining process, is the second one also such a process or, by reason of its connection to the kiln, is it a manufacturing process?

Another major defect of the Treasury's bill lies in the artificial and unrealistic accounting procedures required to compute the percentage depletion allowance.

Under the commercially marketable mineral products rule, the computation is simple. The total sales of the product—gross income from the property—are multiplied by the statutory rate to obtain the allowance.

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What is "gross income from the property" under the Treasury bill? The term is most inadequately defined; if, indeed, it can be said to be defined at all. The bill says that "gross income from the property" is gross income from mining. A number of treatment processes are then indicated to be mining, as has been discussed.

Presumably all income attributable to these processes may be included in gross income from the property and will represent the dollar base to which the appropriate rate will be applied.

However, how is this gross income to be determined?

There is no commercial value for a cement producer's raw materials before the finished cement stage. There is, therefore, no recognizable value which the materials can be said to have before that point is reached. How, then, at the intermediate point in the processing of his material where in the Treasury's conception mining will be deemed to end and manufacturing begins, will a cement producer actually compute the gross income from his property? The bill is silent on this vital question.

The Treasury presumably intends that the computation will be carried out by the cutoff or proportionate profits method prescribed under the regulations which have been declared invalid in the litigation which is the background of this bill. This will reintroduce the endless computation problems that have plagued the cement industry in the past.

It should be emphasized that the cement industry's misgivings do not spring from speculation. They grow out of its experience for more than 5 years with this particular method of computation.

In brief, the so-called cutoff method of computation, as usually administered by revenue agents, assumes that profits are proportionate to costs. The taxpayer is required to compute his costs up to the cutoff point as a ratio of total costs. This resulting ratio is then applied to total sales to secure the gross income from the property up to this cutoff point. The percentage depletion rate is applied to this dollar base to calculate the percentage depletion allowance. This allowance is then measured against 50 percent of net income to determine the allowable figure for income tax purposes.

Quite apart from the fact that, as one judge remarked in holding invalid the Treasury's regulation on this score, gross income computed in this way—

> * * * is obviously a pure fiction which might be false more often than true.—Davis, Jr., in *Cherokee Brick & Tile* v. *U.S.* (46 AFTR 223, 227 (22 F. Supp. 59, 63) (D.C., M.D. Ga., 1954) aff'd. 218 F. 2d 424 (5th Cir. 1955)).

the actual problem of allocating costs on a sound basis in this way is extraordinarily difficult.

Some items, such as the cost of certain labor and repair parts, that is, direct costs, are clearly attributable to a given operation. Indirect costs are another matter altogether. They cannot be determined with accuracy and present complex accounting problems of allocation on which responsible members of the accounting profession differ. The possibilities of differences between revenue agents and taxpayers are obvious.

The result is unfair. The allowance varies for different companies. To some extent, this is attributable to the accounting difficulties. In part, and this is most unjustifiable, the higher allowance will go to

the company whose mining costs are relatively higher than those attributable to manufacturing.

For example, a cement producer whose quarrying costs—being mining—are higher than those of a competitor will receive a larger percentage depletion allowance even though he is the more inefficient producer. There will also be a distinction, in terms of the size of the allowance, between wet and dry process plants in the cement industry.

In the dry process operation the raw material is subjected to drying immediately prior to raw grinding. In the wet process, however, drying takes place in the kiln. The kiln operation is "manufacturing" under the Treasury's bill and no costs attributable to it can be taken into account in computing gross income. Consequently, the dry process producer will be able to allocate to his mining costs, and thus increase his percentage depletion allowance, the cost of a process—drying—which is unavailable to the operator of a wet process plant.

Approximately one-half of the cement plants in the United States are in the "wet process" category. The combination of these discriminations can result in one mill receiving as much as twice the percentage depletion allowance as another.

There is no justification whatsoever for this discrimination between cement producers which the bill will create.

The Treasury's bill is premised on the mistaken doctrine that the depletion allowance is something which is to be attributed to particular processes and that those processes should not be "manufacturing" in the dictionary sense of the word. Such a view of depletion, as the courts have unanimously pointed out in construing the plain language of prior revenue acts, has never been written into the Nation's revenue legislation by the Congress. Rather, the Congress has wisely provided that taxpayers owning and processing minerals should have, as a deduction from gross income, a dollar allowance.

In order to avoid the problems of computation and allocation which have been outlined above, the Congress has wisely chosen the simple formula of using the selling price of the commercially marketable mineral product. What the Treasury's theory ignores is that the allowance arrived at by the use of this principle is attributable, not to a process, but to the natural deposit involved.

The formalism of the Treasury's mining/manufacturing approach leads to the conclusion that a particular process has some magical characteristic which entitles the process and income attributable to it, if indeed income can properly be attributable to it, to receive depletion. This presupposes that there is some clear-cut, equitable measuring rod by which the myriad processes, through which more than 50 different minerals are beneficiated into finished products, can be segregated into "manufacturing" and "mining" categories. If there is any in which this can be done, it has not yet been pointed out.

The Treasury's motivation in proposing this bill is apparently a compound of two factors:

1. The mining/manufacturing argument, which has been discussed above, and,

2. An asserted revenue loss.

There are three comments that should be made in regard to the so-called revenue loss:

First, and even without considering the correctness of any dollar estimates that may be supplied by the Treasury, the concept of any

significant loss necessarily assumes that the commercially marketable mineral products rule will apply generally throughout the cement industry and, as so applied, will operate to produce a cutoff point at the finished cement stage.

The fact is, however, that despite the Supreme Court's refusal in October of 1957 to review this matter, and despite the Internal Revenue Service's public announcement that it would follow the decided cases, not a single refund claim of any cement company has yet been paid by the Internal Revenue Service except in two cases in which the taxpayers received favorable judgment in court.

Consequently, numerous cement producers throughout the country, having reached the conclusion that it is futile to expect refunds for their overpayments through the Service's administrative procedures. have been forced to institute suit in the courts. At least 14 proceedings have already been commenced.

(The names of the companies involved in these suits are set out at appendix C to this statement.)

Mr. MARTIN. In view of the Service's attitude, plus the fact that in numerous instances claims for 1951 and other early years are becoming barred by the statute of limitations, the coming months will see many more.

The outcome of a lawsuit obviously cannot be determined in advance. What the courts will decide regarding the applicability of the commercially marketable mineral products test to the cement industry is a matter which, as a direct result of the Treasury Department's policy of forcing litigation, must await the determination of protracted litigation throughout the country.

Accordingly, the use of the word "loss" is misleading. The Treasury and the Department of Justice have taken the position, administratively and in the courts, that the commercially marketable mineral products test does not necessarily mean that the dollar base for percentage depletion in the cement industry is the value of finished cement. Rather, they assert that where a taxpayer obtains, or perhaps where he could obtain, the reasoning not being wholly clear, a commercially marketable product is a question of fact in each case, and that in some instances a cement producer has a commercially marketable product after preliminary crushing and grinding, well before the prekiln point.

Since this issue is presently the subject of widespread litigation throughout the country in the Federal courts, it is important that this situation be brought to the attention of the Congress. This situation indicates that amendatory legislation in this area is premature, and, if the Treasury wishes to prolong the litigation, should await determination of the issue in the courts.

Running through the Treasury's statements on percentage depletion is the proposition that the commercially marketable mineral products test produces a substantial loss in revenue and that to prevent the occurrence of this loss the statute should be amended.

Table I of the statement presented to the committee by Mr. Lindsay on March 5, 1959, shows a potential tax loss of about $296 million for 30 categories of minerals over a period of 8 years, an average of $37 million a year. Table II, another schedule showing a hypothetical potential tax loss, surely has no basis in fact. The average

annual potential loss in table I is about $37 million, a much more realistic figure than $598,032,000 conjured up in table II.

The word "loss" is improperly used here. Properly considered, in fact, the situation regarding a revenue loss is the exact opposite of what this term implies in the Treasury's memorandum. Actually, as four circuit courts of appeals have unanimously pointed out, the cement and other industries have been entitled to a percentage depletion allowance computed on the commercially marketable mineral products rule during this period. Instead of following the plain meaning of the statutory language, the Treasury wrote a mining-manufacturing theory into its regulations in order to diminish the allowance which the Congress had felt was appropriate for those industries.

The fact is, therefore, that not only has there been no loss in the true meaning of that term, but that for many years the Treasury has been wrongfully collecting a greater tax from the cement and other industries than the statute has permitted or the Congress has intended. And in order to recover this money, these industries have been forced to institute and carry through expensive complicated and time-consuming litigation which is currently being vigorously resisted.

The Treasury's recent statements assert that the rule of commercial marketability will permit the cement industry, and many other extractive industries as well, to compute their percentage depletion allowance by using a dollar base derived from the sale of a marketable product and thereby to increase enormously their depletion allowances; in extreme cases, so the Treasury has said, as much as 100 times.

It is vital that this statement be considered in the light of a very material element of the percentage depletion allowance, the significance of which the Treasury has largely ignored.

From the beginning, the Congress has provided for a definite and effective limitation on the dollar amount of a taxpayer's percentage depletion allowance. This limitation is presently found in section 613(a) which provides:

> (The percentage depletion) allowance shall not exceed 50 percent of the taxpayer's taxable income from the property (computed without allowance for depletion).

In other words, for a taxpayer to be able to deduct 15 percent of gross income he must make a profit margin of 30 percent of gross income before taxes. Such margins are not usually found in the areas covered by table II of the Treasury's presentation and it seems obvious that the alleged potential loss in that table would have been very substantially reduced if weight had been given to this factor. A footnote to the table states that no weight has been given to this factor.

There may well be, as the Treasury has implied, illustrations of industries in which the dollar base for percentage depletion purposes is tremendously high and in which the 50 percent of net income limitation is not significant. The committee can be assured, however, that this is not the case in the cement industry.

For all of the foregoing reasons, it is respectfully suggested that neither the Treasury's present legislative proposal nor any other proposal predicted on the so-called mining-manufacturing theory be written into the Internal Revenue Code.

(Appendixes referred to follow:)

APPENDIX A

STATEMENT OF BOYCE F. MARTIN

List of cement companies subscribing to percentage depletion

NAME OF COMPANY AND LOCATION OF PRINCIPAL OFFICE

Allentown Portland Cement Co., 7th Street at Thruway, Allentown, Pa.
American-Marietta Co., 101 East Ontario Street, Chicago, Ill.
Alpha Portland Cement Co., 15 South Third Street, Easton, Pa.
American Cement Corp., 1530 Chestnut Street, Philadelphia, Pa.
Ash Grove Lime and Portland Cement Co., 101 West Eleventh Street, Kansas City, Mo.
The Bessemer Limestone and Cement Co., 1100 Wick Building, Youngstown, Ohio
Calaveras Cement Co., 315 Montgomery Street, San Francisco, Calif.
Consolidated Cement Corp., 111 West Monroe Street, Chicago, Ill.
Coplay Cement Manufacturing Co., Coplay, Pa.
Dewey Portland Cement Co., 4646 Roanoke Parkway, Kansas City, Mo.
The Diamond Portland Cement Co., Middle Branch, Ohio
General Portland Cement Co., 111 West Monroe Street, Chicago, Ill.
Giant Portland Cement Co., 117 South 17th Street, Philadelphia, Pa.
Glens Falls Portland Cement Co., 313 Warrent Street, Glens Falls, N.Y.
Huron Portland Cement Co., Ford Building, Detroit, Mich.
Keystone Portland Cement Co., 1400 South Penn Square, Philadelphia, Pa.
Kosmos Portland Cement Company, Inc., Starks Building, Louisville, Ky.
Lehigh Portland Cement Co., Young Building, Allentown, Pa.
Lone Star Cement Corp., 100 Park Avenue, New York, N.Y.
Longhorn Portland Cement Co., 1200 Transit Tower, San Antonio, Tex.
Louisville Cement Co., 501 South Second Street, Louisville, Ky.
Medusa Portland Cement Co., Corner Lee and Monticello Blvds., Cleveland Heights, Ohio.
Missouri Portland Cement Co., 3615 Olive Street, St. Louis, Mo.
The Monarch Cement Co., Humboldt, Kans.
Monolith Portland Cement Co., 643 South Olive Street, Los Angeles, Calif.
National Portland Cement Co., 2042 Fidelity-Philadelphia Trust Bldg., Philadelphia, Pa.
Nazareth Cement Co., Nazareth, Pa.
North American Cement Corp., 41 East 42d Street, New York, N.Y.
Northwestern States Portland Cement Co., Mason City, Iowa.
Oregon Portland Cement Co., 111 SE. Madison Street, Portland, Oreg.
Pacific Cement & Aggregates, Inc., 400 Alabama Street, San Francisco, Calif.
Penn-Dixie Cement Corp., 60 East 42d Street, New York, N.Y.
Permanente Cement Co., Kaiser Building, Oakland, Calif.
San Antonio Portland Cement Co., 1301 West Martin Street, San Antonio, Tex.
Southwestern Portland Cement Co., 1034 Wilshire Blvd., Los Angeles, Calif.
Standard Portland Cement Co., Division of Diamond Alkali Co., 300 Union Commerce Bldg., Cleveland, Ohio.
Volunteer Portland Cement Co., Knoxville, Tenn.
The Whitehall Cement Manufacturing Co., 123 South Broad Street, Philadelphia, Pa.

APPENDIX B

SECTION 613 OF THE INTERNAL REVENUE CODE

In the form in which it will be if the Treasury proposal of February 11, 1959, is enacted into law. (Italic indicates proposed Treasury changes.)

SEC. 613. PERCENTAGE DEPLETION.

(a) GENERAL RULE.—In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 percent of the taxpayer's taxable income from the property

(computed without allowance for depletion). In no case shall the allowance for depletion under section 611 be less than it would be if computed without reference to this section.

(b) PERCENTAGE DEPLETION RATES.—The mines, wells, and other natural deposits, and the percentages, referred to in subsection (a) are as follows:

(1) 27½ percent—oil and gas wells.

(2) 23 percent—

(A) sulfur and uranium; and

(B) if from deposits in the United States—anorthosite (to the extent that alumina and aluminum compounds are extracted therefrom), asbestos, bauxite, beryl, celestite, chromite, corundum, fluorspar, graphite, ilmenite, kyanite, mica, olivine, quartz crystals (radio grade), rutile, block steatite talc, and zircon, and ores of the following metals: antimony, bismuth, cadmium, cobalt, columbium, lead, lithium, manganese, mercury, nickel, platinum and platinum group metals, tantalum, thorium, tin, titanium, tungsten, vanadium, and zinc.

(3) 15 percent—

(*A*) metal mines (if paragraph (2)(B) does not apply), rock asphalt, and vermiculite; and

(*B*) *if paragraph (5)(B) does not apply,* ball clay, bentonite, china clay, sagger clay, *and clay used or sold for use for purposes dependent on its refractory properties.*

(4) 10 percent—asbestos (if paragraph (2)(B) does not apply), brucite, coal, lignite, perlite, sodium chloride, and wollastonite.

(5) 5 percent—

(A) gravel, mollusk shells (including clam shells and oyster shells), peat, pumice, sand, scoria, shale, and stone, except stone described in paragraph (6);

(*B*) *clay used, or sold for use, in the manufacture of building or paving brick, drainage and roofing tile, sewer pipe, flower pots, and kindred products; and*

(*C*) if from brine wells—bromine, calcium chloride, and magnesium chloride.

(6) 15 percent—all other minerals (including, but not limited to, aplite, barite, borax, calcium carbonates, diatomaceous earth, dolomite, feldspar, fullers earth, garnet, gilsonite, granite, limestone, magnesite, magnesium carbonates, marble, phosphate rock, potash, quartzite, slate, soapstone, stone (used or sold for use by the mine owner or operator as dimension stone or ornamental stone), thenardite, tripoli, trona, and (if paragraph (2)(B) does not apply) bauxite, beryl, flake graphite, fluorspar, lepidolite, mica, spodumene, and talc, including pyrophyllite), except that, unless sold on bid in direct competition with a bona fide bid to sell a mineral listed in paragraph (3), the percentage shall be 5 percent for any such other mineral when used, or sold for use, by the mine owner or operator as rip rap, ballast, road material, rubble, concrete aggregates, or for similar purposes. For purposes of this paragraph, the term "all other minerals" does not include—

(A) soil, sod, dirt, turf, water, or mosses; or

(B) minerals from sea water, the air, or similar inexhaustible sources.

(c) DEFINITION OF GROSS INCOME FROM PROPERTY.—For purposes of this section—

(1) GROSS INCOME FROM THE PROPERTY.—The term "gross income from the property" means, in the case of a property other than an oil or gas well, the gross income from mining.

(2) MINING.—The term "mining" *means* the extraction of ores or minerals from the ground, *the treatment processes considered as mining described in paragraphs (3) and (4),* and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which such treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary or his delegate finds that the physical and other requirements are such that the ore or mineral must be transported to a greater distance to such plant or mills.

(3) TREATMENT PROCESSES CONSIDERED AS MINING.—*The following treatment processes where applied by the mine owner or operator with respect to the minerals or ores extracted from the ground by him shall be considered as "mining":*

(A) In the case of coal—cleaning, breaking, sizing, dust allaying, treating to prevent freezing and loading for shipment;

(B) in the case of sulfur recovered by the Frasch process—pumping to vats, cooling, breaking, and loading for shipment;

(C) In the case of all other minerals or ores—(i) where applied to crude minerals or ores—crushing, grinding, sorting, screening, washing, and drying to remove free moisture; (ii) beneficiation by concentration, and the processes necessary thereto; (iii) beneficiation by cyanidation, leaching, crystallization, or precipitation, and the processes, necessary thereto; (iv) any additional process, if necessary, to bring the mineral or ore to form and condition suitable for shipment; and (v) loading for shipment. For purposes of this subparagraph, the term "beneficiation by concentration" means the application of processes solely for the purposes of eliminating waste, or separating the mineral or ore from other minerals or ores, by gravity, flotation, amalgamation, electrostatic means, magnetic means, or substantially equivalent processes. The processes referred to in (iv) are those processes which are necessary to bring the mineral or ore to the physical form and condition in which it is capable of being transported as distinguished from those processes applied to make the mineral or ore saleable. The term "loading for shipment" shall not include the cost of packaging unless otherwise provided for under (iv), nor shall it include the cost of containers, bags, or any similar items;

(D) The pulverization of tale, the burning of magnesite, the furnacing of quicksilver ores, and the sintering and nodulizing of phosphate rock.

(4) TREATMENT PROCESSES NOT CONSIDERED AS MINING—*The following treatment processes shall not be considered as "mining":*

(A) In the case of all minerals or ores-electrolytic deposition, roasting, calcining, thermal or electric smelting, refining, polishing, fine pulverization, blending with other materials, treatment effecting a chemical change, thermal action, and molding or shaping, unless such processes are otherwise provided for in paragraph (3); and

(B) Notwithstanding any other provisions of this subsection, any treatment process which follows a process that is not considered as "mining" for the purpose of this subsection.

(5) EXTRACTION OF THE ORES OR MINERALS FROM THE GROUND.—The term "extraction of the ores or minerals from the ground" includes the extraction by mine owners or operators of ores or minerals from the waste or residue of prior mining. The preceding sentence shall not apply to any such extraction of the mineral or ore by a purchaser of such waste or residue or of the rights to extract ores or minerals therefrom.

APPENDIX C

Cement companies which have instituted refund suits

NAME OF COMPANY AND LOCATION OF PRINCIPAL OFFICE

Allentown Portland Cement Co., 7th Street at Thruway, Allentown, Pa.
Alpha Portland Cement Co., 15 S. Third Street, Easton, Pa.
Arizona Portland Cement Co., 612 S. Flower Street, Los Angeles 17, Calif.
California Portland Cement Co., 612 S. Flower Street, Los Angeles 17, Calif.
Consolidated Cement Corp., 111 W. Monroe Street, Chicago 3, Ill.
General Portland Cement Co., 111 W. Monroe Street, Chicago 3, Ill.
Keystone Portland Cement Co., 1400 S. Penn Square, Philadelphia 2, Pa.
Lehigh Portland Cement Co., Young Building, Allentown, Pa.
Missouri Portland Cement Co., 3615 Olive Street, St. Louis 8, Mo.
Monolith Portland Cement Co., 643 S. Olive Street, Los Angeles 14, Calif.
Northwestern States Portland Cement Co., Mason City, Iowa
Permanente Cement Co., Kaiser Building, Oakland 12, Calif.
Riverside Division American Cement Corp., 621 S. Hope Street, Los Angeles 17, Calif.
The Whitehall Cement Manufacturing Co., 123 S. Broad Street, Philadelphia 9, Pa.

APPENDIX D

THE LEGISLATIVE HISTORY OF SECTION 613(c) OF THE INTERNAL REVENUE CODE OF 1954

Percentage depletion for minerals other than oil and gas was first allowed by the Revenue Act of 1932. Prior to that time, however, the staff of the Joint Committee on Internal Revenue Taxation made a study of percentage depletion for metal mines and submitted a preliminary report to the committee.[1] Mr. Alex R. Shepherd, mining engineer for the joint committee, submitted a technical report which was attached as appendix XXXI to the staff's report to the committee. This Shepherd report recommended percentage depletion for metal mines computed on "gross income from the property" and discussed the meaning of this term. At page 68 Mr. Shepherd states:

"It will be necessary to define what is meant by gross income from the property and to definitely indicate the point in accounting at which it is to be determined as well as other details. This can be done, either in the act, or interpreted in the regulations.

"The consensus of opinion seems to be that the act should be written as simply as possible (as in the case of oil and gas) and the necessary definitions should be written into the regulations."

The report recommended (pp. 70–71) that the statute provide that, in the case of metal mines, the allowance for depletion be "15 percent of the gross income from the property," subject to a limitation of 50 percent of net income from the property. In respect to the computation of "gross income from the property," the report further states (pp. 71–72):

"In the case of the smaller operator, the product in most all cases is sold in the crude or semirefined (concentrate) state to smelter under contract or otherwise.

"The smelting after weighing and sampling the ore or concentrate renders the seller a statement setting forth:

"The gross metallic contents of the shipment.

"Net metallic contents and market quotation.

"Deduction for all costs, of freight, treatment, penalties, etc.

"Net value in dollars and cents to seller (known as the net smelter returns) and a check in favor of seller for the product sold. Each ore shipment to the smelter is generally liquidated in the above manner.

"*Therefore, in the case of 90 percent (in numbers) of the taxpayers their gross income from the property is the smelter return settlement, less royalty due lessors.*" (Emphasis supplied.)

This language clearly indicates an intent to compute the depletion allowance on the selling price of the concentrates, which are shown to be the commercially marketable products in the case of 90 per cent of the miners.

When the depletion allowance for metal mines was added to the statute in 1932, the statutory language followed Mr. Shepherd's suggestion; that is, the statute provided a depletion allowance for metal mines computed as 15 percent of "gross income from the property," with the definition of "gross income from the property" left to regulations.

The Bureau seems to have originally followed Mr. Shepherd's suggestions as to the computation of "gross income from the property." While the regulations did not expressly state the commercially marketable mineral product rule, they did provide for the inclusion in computing gross income, of certain enumerated processes and similar processes as well. Moreover, although there are no published rulings under these regulations showing how they were applied, the later legislative history does show what Congress was told regarding the Treasury interpretation.

The Bureau did not originally limit the processes includable in determining gross income from the property to those specifically listed in the regulations, but did allow many others to be included.[2] Congress was told in 1942 that the

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[1] Reports to the Joint Committee on Internal Revenue Taxation from its staff, vol. 1, pt. 8 (1929).

[2] Hearings before the Committee on Finance on the Revenue Act of 1943, 78th Cong., 1st sess., pp. 527–528.

Treasury had taken the position that gross income was to be based on the first marketable product. Thus, if the mine owner sold his first marketable product, the gross income was based on the value of that product; if he applied further processes after obtaining the marketable product, an allocation had to be made.[3] But Congress was told at the same time that the Treasury had changed its position as to cinnabar ore from which mercury is obtained and was trying to exclude processes applied before the commercially marketable product was obtained.[4] A member of the Ways and Means Committee was "astonished" to learn that the Treasury was seeking to cut off the computation of the deduction for cinnabar ore before income could be realized from the ore.[5]

When this change in practice as to cinnabar ore was brought to the attention of Congress in 1942, the Treasury urged that the matter should be handled administratively, promising that it would adhere to its original regulations and procedures, and urging that Congress not act.[6] Congress in 1942 relied on this representation, but the Treasury apparently did not adhere to its original position as it said it would. In addition, in 1943 Congress was given the further information that the Treasury had been seeking since 1941 to exclude all processes not specifically listed in the regulations.[7] In the light of this situation, Congress enacted, in section 124 (c) of the Revenue Act of 1943, the statutory definition of "gross income from the property."

In explaining the new provision, which originated as an amendment in the Senate Finance Committee, the committee stated:

"The purpose of the provision is to make certain that the *ordinary treatment processes which a mine operator would normally apply to obtain a marketable product* should be considered *as a part of the mining operation*, and to give reasonable specification of what are to be considered such processes for various kinds or classes of mines.

"The law has never contained such a definition, and *its absence has given rise to numerous disputes*. The definition here prescribed expresses the congressional intent of these provisions as first included in the law, and is in accord with the original regulations and the Bureau practices and procedures thereunder. It is therefore made retroactive to the date of such original provisions." [Emphasis supplied.] (Sen. Rept. 627, 78th Cong., 1st sess., pp. 23–24, 1944 C.B. 991.)

The logic of the purpose of this part of section 613(c), explained above, is especially clear in view of what Congress sought to accomplish through its enactment. Congress was seeking to end numerous disputes, caused by the Treasury's attempt to whittle away at the depletion deduction. Congress wanted a simple, practical, definite rule. Certainly the rule adopted was the one best suited for that purpose, since, where there is a marketable product, the market price can easily be ascertained and used as a basis for computing the deduction.

The legislative history also shows that Congress was concerned here only with practicalities and with finding a workable rule. There is no hint that Congress was concerned with the technicalities of whether chemical changes occur in obtaining a marketable product. There is no suggestion that commercially marketable mineral product or products is to be restricted to a mineral in its natural state. There is no support for the assumption that manufactured processes are to be excluded from the term "mining" as specially defined in the statute. On the contrary, the legislative history affirmatively shows that Congress meant exactly what it said when it provided in clear and unambiguous language that "'mining', as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products."

The CHAIRMAN. Are there any questions of Mr. Martin?

Mr. Simpson will inquire, Mr. Martin.

Mr. SIMPSON. Mr. Martin, you recognize, I am sure, as Congress did some years ago, that in order to provide and ascertain the gross

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[3] Hearings before the Committee on Ways and Means on Revenue Revision of 1942, 77th Cong., 2d sess., pp. 1199, 1202.
[4] Ibid.
[5] Ibid.
[6] 88 Congressional Record, pt. 6, Oct. 10, 1942, p. 8033.
[7] Supra, footnote 2.

income, a point would have to be determined, whether by law or by the wishfulness or wistfulness of the parties who were undertaking to determine the cutoff point.

The law gave what the courts have found to be a certain definition, namely, a marketable product, and the courts are generally holding that to be the point at which the gross income shall be determined.

If I understand your statement, it is that in your opinion or the opinion of your industry, the certitude which is now shaping up with respect to that definition should be maintained and gross income should be determined at the point of the first marketable product.

Mr. MARTIN. Yes, sir; that is correct.

Mr. SIMPSON. Any other approach that comes to mind, certainly the one suggested by the Treasury, would bring into being a situation of great uncertainty and lead into a great deal more litigation?

Mr. MARTIN. That is our position, sir.

Mr. SIMPSON. Inasmuch as we have spent 6, 7, or 8 years at least in undertaking to ascertain through the courts what this first marketable product meant, and inasmuch as we are now reaching some degree of certitude in that area, is it your suggestion that to shift from that to another method might lead us into greatly increased litigation in the coming years?

Mr. MARTIN. I definitely believe that; yes, sir.

Mr. SIMPSON. Are you alarmed lest this determination of the first commercially marketable product point applied to many industries might lead us into an area of entirely uncontemplated revenue cost in the whole area of depletion allowances?

Mr. MARTIN. No, sir; not if the rule is applied, that is, the ordinary treatment processes required to bring the mineral product to a commercially marketable mineral market or where it can be sold in such a market; so long as that rule stands I am not concerned.

Mr. SIMPSON. You conclude then that the certainty that we have achieved in your judgment is more desirable than creating a situation which could in the future lead to a long period of uncertainty by the industry?

Mr. MARTIN. That is correct.

Mr. SIMPSON. You are speaking for the cement industry. Are you in fact indicating a belief with respect to the whole subject of depletion and the bill before us?

Putting it another way, do you believe that there are some areas that the Congress should open up, or should we keep the whole thing in status quo for the present?

Mr. MARTIN. We believe that it should remain in its status quo.

Mr. SIMPSON. And permit the courts to make the definitions where there is uncertainty?

Mr. MARTIN. Yes, sir.

Mr. SIMPSON. Thank you.

The CHAIRMAN. Mr. Watts will inquire, Mr. Martin.

Mr. WATTS. Mr. Martin, I would like to compliment you on this fine statement that you have made to the committee. It certainly points up the problem that it seems an industry would have if the Treasury's version of the law should be adopted.

I take it that you would have to adopt a new base each year dependent on the relative costs of the various operations, would you not?

Mr. MARTIN. I didn't quite understand the question. I don't understand what base you mean.

Mr. WATTS. In the event that the Treasury's proposal was enacted into law, if I follow their proposal, they begin at your cost and attribute back to each operation a certain value and your depletion allowance is figured on the value that they have allocated to a certain cutoff point. Once that is figured for your company, that would be of no benefit the following year, is that right?

Mr. MARTIN. That is correct.

Mr. WATTS. It would be a different figure in each year?

Mr. MARTIN. That is right.

Mr. WATTS. And if I followed your statement, that the first time that any product of the cement industry can be marketed is after it actually becomes cement.

Mr. MARTIN. That is correct.

Mr. WATTS. I would like to again compliment you on this fine statement.

The CHAIRMAN. Mr. Mason will inquire, Mr. Martin.

Mr. MASON. Mr. Martin, your statement in my opinion was a very effective and logical one in which you took up point by point the Treasury's proposal. Is this the picture that is facing this committee: that a few years ago we did establish a plain, clear cutoff point for the application of the depletion rate; that, further, the Senate report further clarified it; and then along came the Treasury who said, "We will not accept it", and then the courts further clarified the law, and then the Treasury insists that they will not accept that cutoff point and in their regulations they have issued what might be called a mining-manufacturing theory which is about as obscure as anything I have run across?

For instance, they say a thermal action in one process for one mineral is not manufacturing, but thermal action in the cement industry is manufacturing. It is mining here, but manufacturing here, and you could go on and pick flaws with it for a considerable length of time. Now they come to us in this bill and with their proposal and they say to the Congress, "We want you to adopt by statute our definition and throw out the window, the 6 or 8 years of experience," and open up Pandora's box, I would say, of confusion and further litigation.

Is that about the picture that is before us?

Mr. MARTIN. Yes, sir; that is certainly our position.

Mr. MASON. You say at the close that you do not think we should do that, but you do not say what we should do. If the cement industry is getting more depletion than it should on the basis of present law, would it be all right in your opinion to cut the 15 percent, say, to 10 percent, or to 5 percent, or reduce the rate and leave the base stay as it is?

That seems to me to be simple.

Mr. MARTIN. That is simple and obviously would be a very drastic cut for our industry. I could not in all honesty say that the cement industry should not accept in good grace if this committee in all equitableness looked at the rates of all industries and said "Yes, you among others must be cut", or "You among others must be raised."

This thing is not susceptible of exact determination. That has been one of the whole thing from the beginning of its history. Therefore,

all we can say, Mr. Mason, is treat us fairly and equitably as compared to other mineral industries.

Mr. MASON. That means then that if we should let this base stay as it is, as it has been established by law and by the courts, and enter this great consideration, we ought to then take in rates for all things, particularly oil and gas.

I am inclined to agree with you, if we enter that field we are going to be on it for a long, long time, Mr. Martin. How much of the cement industry do you represent?

Mr. MARTIN. Approximately 70 percent; a little more than 70 percent.

Mr. MASON. About 70 percent in production?

Mr. MARTIN. Yes, sir.

Mr. MASON. With respect to the other part, the 30 percent, have they other views, or have they anyone presenting their views?

Mr. MARTIN. Some of them, I understand, share other views.

Mr. MASON. Their views, as I get it, were explained to us, I guess it was Friday, by Mr. Arnold, was it not, Mr. Chairman?

The CHAIRMAN. We did have a witness on Friday.

Mr. MARTIN. I believe he mentioned that he represented some.

Mr. MASON. That is all, Mr. Chairman.

The CHAIRMAN. Are there any further questions?

Mr. Baker will inquire.

Mr. BAKER. Mr. Martin, I am sorry, I was at another meeting, which at least I considered very important, and did not hear all of your statement, but I think I get the gist of it.

Since apparently the situation with respect to cement rates brought on this whole contoversy, does the cement industry have any suggestion, if a bill is to be reported, of a different rule that would be fair to the cement industry from the one in the 1954 code?

Mr. MARTIN. No, sir.

Mr. BAKER. You presented no alternative rule and nothing alternative to the commercially marketable mineral product test?

I am not trying to compromise anything, but in your judgment is there a workable and feasible rule somewhere between the Treasury proposal and the present interpertations, which seem very clear, of the commercially marketable mineral products test. In other words, is there some place you could cut off?

Mr. MARTIN. Definitely not in my opinion, sir.

Mr. BAKER. Of course, if we should go into rate, you feel that certainly we shouldn't as limited to cement.

Mr. MARTIN. That is correct, and I don't mean to point any fingers, except that, as I understand it in the statute, everything except grass, air, and water, and dirt has some form of percentage depletion allowance, and I think the relationships of all those mineral products in terms of the depletion allowance philisophy should be examined, and that the easiest way, the way that has never been, as I understand it, questioned by the courts, is the rate of a particular industry.

Mr. BAKER. When you say "revenue loss," or whatever it is, there is a considerable amount of money involved in this cement controversy.

Mr. MARTIN. In terms that a million dollars is a lot of money; yes, sir.

Mr. BAKER. About how much money is involved; do you know?

Mr. MARTIN. I have no idea in terms of the cement industry as such.

Mr. BAKER. Of course the argument is made, and it may or may not be true, that with a 15-percent rate on cement, in applying this commercially marketable mineral products test, the cement industry actually gets more depletion than all of the oil and gas industry with 27½ percent. That argument has been batted around.

What do you think about that?

Mr. MARTIN. I have no fact, but my personal opinion would be that there is a substantial difference, as I understand it. The oil and gas industry is so much larger in my opinion. I have no figures.

Mr. BAKER. However, you do feel that with this extractive product or these products, there just suddenly is not any cutoff place and fixed depletion until it is cement?

That is what it boils down to?

Mr. MARTIN. That is any fair cutoff, equitable?

Mr. BAKER. Of course, there is some discussion of putting it at the point that it goes into the kiln.

Mr. MARTIN. There again, Mr. Baker, I don't think that proposal, for the reasons we have explained, is nearly as sound as the commercially marketable mineral product test, but if such a contingency came about, I think that those processes ought to be examined very minutely to be sure that they were all the processes that should be allowed, if I understand your question correctly.

Mr. BAKER. One other point, and I think it is pretty important.

Statements are made that this cement rock, we will call it, as distinguished from limestone, or chemical lime—or any other limestones that have very definite values when extracted from the soil, as such has no value. This is point No. 1.

I question that because it certainly has a definite value as cement rock in my mind. It is also argued—I would like you to comment on the first one and then I will give you the second one as a corollary to it—that there are almost limitless quantities of it, although we have had no testimony on that, that we have this particular limestone that goes into cement and you can just reach out here and get it anyplace. Of course I know that is not true.

Is it almost limitless? Do you explore for it like you do for other minerals? What is the situation?

Mr. MARTIN. Mr. Baker, I interpolated a statement in the record—it is not in this prepared statement—on just that point; that it is difficult to find. It is expensive to find. In fact it is the other way around.

In the experience of those of us in the industry, is is a very difficult thing to locate and a very unique mineral body when you discover it in the proper place in the proper quantities.

Mr. BAKER. I am glad you said that because that is one of the big arguments. Some people say this cement rock has no value; therefore, what is there to deplete? Why should they have any percentage depletion?

It is unique in that you do search for it. You want that particular type of stone to make cement, and you have to search for it just the same as they do for other minerals in the ground?

Mr. MARTIN. Yes, sir.

Mr. BAKER. Then does it have a value in its form as cement rock?

Mr. MARTIN. Not for our purposes, because as rock or dust or raw mix, there is nothing for which it can be used in terms of the expenses

and the difficulties of locating it in the first place, of the number of dry holes that we run in searching for the proper quantities and the proper content of cement rock.

Mr. BAKER. Does it have any commercial use for any purpose other than cement?

Mr. MARTIN. The cement rock as such does not. In terms of the purpose and function for which you were searching, yes, sir, there are types of cement rock which can be sold for other purposes, but that would not be the reason why you spent money to find that particular body of minerals to start with.

Mr. BAKER. However, the cement industry, and if I am wrong please tell me, does go out under the next section of the code, or whatever it is, and actually explore and discover new fields of this basic material, just the same as is done for coal and oil, and gas, and other minerals?

Mr. MARTIN. They certainly do, and I wish you discovered every time you explored. But the difficulty is you search in many places in which you do not locate the proper type.

Mr. BAKER. Thank you.

The CHAIRMAN. Mr. Ikard will inquire.

Mr. IKARD. You were talking about searching. How much does your industry spend each year percentagewise or moneywise searching for this?

Mr. MARTIN. Mr. Ikard, this is a very highly competitive industry. It is also a very individualistic industry. In my own case I would not expose that figure to anyone except someone within the company.

I will be glad, if you consider it necessary, to give you any figures that I could develop myself in complete confidence, but I would say that is the most highly competitive confidential information because it is a question of where will the next new plant be constructed.

Mr. IKARD. I did not realize that. I certainly would not want you to disclose any information of that type here. I do think, though, before this committee can deal intelligently with rates, as you suggest, that we ought to have such figures and should not be just told that this is highly competitive and this is confidential, if you expect us to do a good job on this.

It seems to me, and it is a little off the subject, but you have raised it in your discussion with Mr. Baker and others, that if you expect this rate change, certainly the committee would need to know, or at least I as one member would like to know or have some idea of what you are talking about.

If this rate is too low and if you need an increase to carry on your search and exploration for new sources, as far as I am concerned I think that is something that should be taken into consideration, but, on the other hand, if we are going to do it we have to have the information.

Mr. MARTIN. I can speak only for myself there, sir, because this is in the area of very intense competition.

For my own company, I shall be glad to supply that information on a confidential basis to any designated part of this committee.

Mr. IKARD. That is all, Mr. Chairman.

The CHAIRMAN. Mr. Utt will inquire, Mr. Martin.

Mr. UTT. Mr. Martin, I also want to compliment you on a very complete and enlightening statement on the situation as it is now and

as it would be under the Treasury proposal, but as president of your own company I did want to ask you for the record if you will state your position or your idea of the basic theory and philosophy of depletion.

Mr. MARTIN. I am not a trained lawyer. I have no background as far as the legal side is concerned, but as I understand it in terms of its effect on an industry, starting back in 1913 with the application of the introduction of an income tax law in the first place, there was a recognition that there were certain values related to the discovery or the establishment of certain mineral bodies at a particular point, either in reference to the market or elsewhere; that to the extent that not all searches were successful; that is, the discovery value represented something more than perhaps the actual cash dollars you, through second or third parties, actually paid for the land in the hope that you could, or after an option that you would, use to core drill or explore that land, there was a discovery value there that was very difficult to determine, because that discovery value varied as the country developed and as the population grew. So that in attempting to refrain from taxing capital there developed the theory first of discovery value, then the percentage depletion as a replacement of discovery value, but in addition recognizing that these mineral bodies could never be replaced. They were being depleted. The things that had taken millions of years to form were being used up annually in great quantities. They could never be replaced. New ones had to be found.

Therefore, in this philosophy of percentage depletion, as I understand it, there was needed also an incentive to acquire and develop new deposits and encourage the enlargement of known reserves. That is the purpose of percentage depletion.

Mr. UTT. You consider it two pronged, one, for replacement of wasting assets; second, an incentive for discovery?

Mr. MARTIN. Yes, sir.

Mr. UTT. My question then would be, based on that, do you use in your company the total amount of dollars that you take as a depletion deduction for replacement of your reserves and for other discoveries, or do you apply it to increased dividends?

Mr. MARTIN. I can answer that in two ways.

In one plant, yes, the answer is yes, we have used more than the percentage depletion allowance in the search for new properties.

In another, the answer is no, the percentage depletion allowance is greater, but it has not been used for dividends; that is, the money has been used in an enlargement of the plant and the purchase of new reserves.

Mr. UTT. It is your general belief that the depletion allowance is not used as a tax gimmick, but it is actually used for replacement of reserves, discovery of new ones, and perhaps some plant expectation?

Mr. MARTIN. I think that is true, and I think, without getting into the economics of it, the growth of the cement industry since 1951 is proof of that.

Mr. UTT. And you would say that your consolidated statement would undoubtedly show that in some cases there was additional money available, and in others the depletion was more than the reserves, but as a total they would probably balance out in expenditures?

Mr. MARTIN. No, sir; I didn't say that. I didn't mean that.

Mr. UTT. I misunderstood you then.

Mr. MARTIN. I said in one plant, and that is a small plant, that was the case.

In another, in our large plant, that would not be the case, and as to the sum total of the two, no, we have not spent that much.

Mr. UTT. The sum total would be that you would spend more money for replacement of reserves and discovery of new reserves than your total dollar allowances on depletion?

Mr. MARTIN. No, sir; the other way around. We have not spent as much on replacement of reserves as such as we get in the dollar allowance of depletion.

Mr. UTT. Therefore, your actual dollar allowance for depletion exceeds your replacement?

Mr. MARTIN. Yes, sir.

Mr. UTT. That is all, Mr. Chairman.

The CHAIRMAN. Mr. Byrnes will inquire, Mr. Martin.

Mr. BYRNES. Mr. Martin, I am disturbed by your conclusion on page 25. Do I gather from that that you believe that no effort should be made to distinguish between mining and manufacturing in the application of a depletion allowance?

Mr. MARTIN. As shown by the Treasury's proposal.

Mr. BYRNES. You said, "nor any other proposal predicated on the so-called mining/manufacturing theory."

Mr. MARTIN. Yes.

Mr. BYRNES. Does that mean your conclusion is that we should not try to draw a distinction between the mining aspect and the manufacturing aspect in applying percentage depletion?

Mr. MARTIN. I have said I believe the definition of the ordinary treatment process required to bring mineral to a commercially marketable product is a better way to calculate percentage depletion.

Mr. BYRNES. Then should we provide depletion on sand, let's say, and because glass—I understand glass is made from sand—apply the percentage depletion on the basis of the value of plate glass or the finished product of glass?

Mr. MARTIN. I do not believe that would qualify as a commercially marketable mineral product on the basis of the processes, but I am not familiar with the glass industry.

Mr. BYRNES. It starts out as something in the ground, does it not, or consisting of the ground?

Mr. MARTIN. Yes, sir.

Mr. BYRNES. It ends up as a commercial product. Should we add some more items to the group that we allow percentage depletion on?

Mr. MARTIN. No. The point I am confused about, Mr. Byrnes, is I am not sure whether, in the process of sand, the ordinary treatment processes, at some stage prior to glass they arrive at a commercially marketable mineral product. If they do, that is the point at which the percentage depletion would be allowed.

Mr. BYRNES. Your cement rock certainly has some value if you are spending a lot of money exploring for it. Once you find it, there ought to be somebody who would be willing to buy it from you if they are spending a lot of money trying to find it.

Mr. MARTIN. A competitor; yes, sir.

Mr. BYRNES. So it would have a market?

Mr. MARTIN. Not as a continuing operation of your particular company.

Mr. BYRNES. It would be commercially marketable to your competitor then, would it not? Somebody will want it. We are going to be building highways and using cement, I expect, for some period of time.

Mr. MARTIN. I think that would be very difficult, just as difficult to determine the value as we have now in this situation of determining what is the value of a mineral product in place that has been discovered in a unique situation.

Mr. BYRNES. I am just wondering whether we have gotten to the point now where we are going to suggest that it is the creation of a commercially marketable product that gives rise to the need for depletion allowances, and if so, whether everyone who is manufacturing some commodity is entitled to depletion allowance, because it all starts back in some natural resources of some kind.

Mr. MARTIN. Not in my opinion, sir, within the framework of the philosophy of percentage depletion, as I understand it, because you need to allow in that only, say, those treatment processes that are required to bring it to the commercially marketable mineral product.

Mr. BYRNES. Even if that means putting it in the bags and putting a label on them? You do not give any recognition to a mining process as distinguished from a manufacturing process?

Mr. MARTIN. Not as a dichotomy, not as a specific classification of two separate functions that can be always separated.

Mr. BYRNES. Well, in the case of iron ore then, you would say that is the thing to do, because it is not commercially marketable basically until you have it in sheet steel or have it in the form of an automobile?

Mr. MARTIN. I wouldn't say that was a mineral product; no, sir. I am not a mining economist, but I understand there were markets prior to that stage, with prices quoted for a mineral product.

Mr. BYRNES. Nobody quotes any price or tries to sell an area of cement stone?

Mr. MARTIN. Not as such that I know of, unless it is in a location that is distant to many plants or a location not close to a market.

Mr. BYRNES. Frankly, I just wonder how long we can sustain depletion allowance if we are not going to base it on the mining aspect, but are going to take the attitude like the salt people took the other day, and as I gather you take here today, that we apply it against gross income right from the ground to the retail outlet.

Mr. MARTIN. I don't believe, sir, that I would subscribe to that.

Mr. BYRNES. You apparently contend that there is no manufacturing process here at all, or that if there is a manufacturing process, you should get depletion on the manufacturing process. If we come to that we will have to recognize there are a lot of people in the business of manufacturing who create a commercially marketable product.

Mr. MARTIN. Mineral product.

Mr. BYRNES. Well, I do not know how you can draw the distinction between mineral and any other product if you are going to eliminate the mining aspect of it and not draw a distinction based on mining.

Mr. MARTIN. The present distinction is based on the processes required for a mineral product, and it is not merely the extraction of the ore, according to the statute; it is the ordinary treatment processes.

Mr. BYRNES. I just wonder, according to your theory, if it would not require us to move into other areas besides the mineral area. The mineral area involves the mining process and we give a percentage depletion for that. If you are going to apply it to the manufacturing process, then maybe there are a lot of other people in this country, because they are putting a lot of effort into creating a commercially marketable product, who also ought to be included in the area of depletion.

Mr. MARTIN. Not with the understanding that I have the reason why percentage depletion is given in the first place, because that would be for a mineral product.

Mr. BYRNES. That is all, Mr. Chairman.

The CHAIRMAN. Are there any further questions?

Mr. Alger will inquire.

Mr. ALGER. Mr. Martin, I listened to your statement very carefully. Do I understand that the net effect in your mind of the existing law, or the net effect of the Treasury's attitude, has been to go around congressional intent by redefining mining/manufacturing? Is that correct?

Mr. MARTIN. That is my understanding, sir; yes, sir.

Mr. ALGER. Secondly, I think you maintain that what the Treasury calls loss might have well been money they were not entitled to in the first place.

Mr. MARTIN. That is definitely our position.

Mr. ALGER. To recover it, you must sue?

Mr. MARTIN. Yes, sir.

Mr. ALGER. Do you have a hope of getting that money back, and if you do, will you get litigation costs back?

Mr. MARTIN. I don't know, sir.

May I ask one of my colleagues to answer that? I am not a lawyer.

The CHAIRMAN. Yes.

Mr. MARTIN. I understand you do not get litigation costs back.

Mr. ALGER. Do you get interest on the money?

Mr. MARTIN. Yes, sir.

Mr. ALGER. Yours is a very forceful statement with respect to an area that has been troubling us.

Do you see no inequities in the present depletion allowance where industries are getting money for what in effect are manufacturing processes?

Mr. MARTIN. I don't believe that they are, as you say, in effect manufacturing processes.

Again, we haven't gotten any money. I believe that if there is some question in that regard, it is not a single industry that is involved. I believe it must be related to the whole picture of all minerals and I believe all minerals now get some form of percentage depletion.

Mr. ALGER. Let me put it this way: Would you call your industry a unique industry?

Mr. MARTIN. Unique is the sense of the mineral body which we must discover, unique in the sense of the product which we produce, but the processes used are used in a number of mining industries.

Mr. ALGER. Would you say that there is a uniqueness then in other industries and that each industry spokesman feels his industry to be unique in the processes as well as the substance involved?

Mr. MARTIN. I would imagine some who feel they would be unique in the processes too.

Mr. ALGER. Do you feel that a general formula could be discovered to cover unique industries and such a matter then could be resolved without separately treating each one just by itself?

Mr. MARTIN. Not on the Treasury basis.

I believe under the Treasury proposal, it would have to be a very careful analysis of each industry and each process to be sure that there were no inequities or no processes that were allowed in one and not allowed in another. Does that answer you?

Mr. ALGER. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. Are there any further questions of Mr. Martin?

If not, Mr. Martin, we thank you, sir, for appearing in behalf of the cement industry. It is my understanding in the coordination of the testimony your statement is representative of the feeling of all in the industry who requested an opportunity of being heard before the committee. Even though your organization only represents 70 percent of the total industry, it does represent 100 percent of the people who applied to be heard before this hearing?

Mr. MARTIN. I believe that is correct.

The CHAIRMAN. We appreciate so much the fact that the industry could coordinate its statement and that it was not necessary in the opinion of the industry to have an unlimited number of witnesses appear before the committee.

We thank you, sir.

Mr. MARTIN. Thank you, sir.

(The following statement and letters were filed with the committee:)

SUPPLEMENTARY STATEMENT OF BOYCE F. MARTIN, PRESIDENT, THE LOUISVILLE CEMENT CO.

I am Boyce F. Martin, of Louisville, Ky. I am president of the Louisville Cement Co. I am submitting this supplementary statement on behalf of the 38 cement companies listed in appendix A of my statement before this committee on March 9, 1959.

This supplementary statement is filed in order to clarify the applicability of the commercially marketable mineral products test to the inclusion of (*a*) income attributable to cement bags; and (*b*) income attributable to placing cement in bags in the computation of gross income from the property in the cement industry.

From the questioning following my statement before the committee on March 9, it appeared that Representative Byrnes may have been under the impression that the commercially marketable mineral products test would permit a cement producer to include income attributable to both of these items in the percentage depletion base.

This is not correct.

The commercially marketable mineral products test provides, in effect, that the dollar base for percentage depletion shall include income from all treatment processes applied by the taxpayer in order to obtain a commercially marketable mineral product. The first commercially marketable mineral product obtained in the cement industry is finished cement in bulk. Consequently, the commercially marketable mineral products rule, properly interpreted for the cement industry, does not permit cement producers to include in the depletion base income attributable to (*a*) cement bags (including, of course, the cost of printing labels thereon), or (*b*) the placing of cement in bags.

The committee will also be interested to learn that this issue is rapidly being settled in current litigation. Indeed, as indicated below, it may now already be largely resolved.

The precise question has received full judicial consideration in the gilsonite industry. Gilsonite is a hydrocarbon substance used in the asphalt tile industry and in the ink and paint industries. After extraction and processing, it is placed in bags before it is sold. A taxpayer asserted that income attributable to the bagging of gilsonite, as well as income attributable to the bags, should be included in the depletion base. The U.S. Court of Appeals for the Tenth Circuit ruled against the taxpayer (*American Gilsonite Co.* v. *Commissioner of Internal Revenue*, 259 F. 2d 654 (1958)). Two weeks ago—on March 2, 1959—the U.S. Supreme Court refused to review this issue, thus leaving undisturbed the decision of the court of appeals (27 L.W. 3242).

This same court last year—on June 10, 1958—had also decided in a case involving another mineral—perlite—that income attributable to the bags and the bagging operation could not be included in the depletion base (*United States* v. *Utco Products, Inc.*, 257 F. 2d 65).

It is to be regretted that the Treasury did not call the committee's attention to the significance of these recent developments.

(The following material was filed with the committee:)

COVINGTON & BURLING,
Washington, D.C., March 10, 1959.

LEO H. IRWIN, Esq.
Chief Counsel, Committee on Ways and Means, House Office Building, Washington, D.C.

DEAR MR. IRWIN: On behalf of the National Sand and Gravel Association, I enclose three copies of the statement of Mr. Robert Mitchell, acting chairman, committee on taxation of the association, for inclusion in the record of the hearings before the Committee on Ways and Means on the Treasury Department's proposed draft of legislation specifying the treatment processes which shall be considered mining for the purpose of computing percentage depletion in the case of mineral products.

I should also like to make clear, and I would appreciate your including this point in the record of the hearings, that only the National Sand and Gravel Association has authority to speak for the commercial sand and gravel industry of the United States. We submit this request in order to make certain that no erroneous implication with respect to our members will be drawn from statements of other organizations speaking for various branches of the mining industry.

Our association believes that the commercially marketable mineral products test should be retained. Its elimination would require elaborate accounting computations of costs and profits at the cutoff point, and would lead to endless controversy between revenue agents and taxpayers. Small producers in particular would be at the mercy of a revenue agent, since there is no way of avoiding allocations of indirect costs and profits which in the last analysis are matters of judgment. The selling price of a commercially marketable mineral product is a simple objective test, easy to administer. Neither the revenue agent nor the taxpayer can argue about it.

Respectfully,

JOHN T. SAPIENZA,
Counsel.

STATEMENT OF ROBERT MITCHELL, ACTING CHAIRMAN, COMMITTEE ON TAXATION OF THE NATIONAL SAND & GRAVEL ASSOCIATION

My name is Robert Mitchell. I am president of the Consolidated Rock Products Co., Los Angeles, Calif. This statement is submitted in my capacity as acting chairman of the committee on taxation of the National Sand & Gravel Association. The association, organized 43 years ago, represents the commercial sand and gravel producers of the United States. Its membership accounts for approximately 75 percent of all commercial sand and gravel production.

The committee on taxation has studied the proposed legislation submitted by the Honorable Robert B. Anderson, Secretary of the Treasury, which would amend the Internal Revenue Code by specifying the treatment processes which

shall be considered mining for the purpose of computing percentage depletion in the case of minerals. Our committee believes that the Secretary's proposals should be revised in three respects for the purpose of eliminating ambiguities and vagueness. If this is not done, protracted and expensive litigation, a burden both to the Treasury Department and the taxpayer, can hardly be avoided.

(1) The proposed elimination of the test of "commercially marketable mineral product or products" and the substitution of a new definition of "mining" which would specify allowable treatment processes for the various minerals would abandon a statement of purpose by the Congress which now has a well-established meaning. The new proposed test will create problems where none now exist and will create new problems of administration and judicial interpretation.

(2) The Secretary proposes that "fine pulverization" shall not be considered as an allowable process in the determination of gross income from mining. The Secretary also proposes that "grinding" shall be regarded as a necessary part of mining. So far as the ordinary meaning of the word "grinding" is concerned, this would seem to be quite sufficient from the standpoint of the operating practices of the sand and gravel industry; but it is impossible to formulate a precise rule which will lead to a clear distinction between grinding and fine pulverization, and this being so, the Secretary's proposal is open to the obvious objection that needless and expensive administrative difficulties will follow if his proposal is accepted by your committee.

The National Sand & Gravel Association urges that any processing for the purpose of reducing the size of the mineral or ore, whether it be crushing, grinding, fine grinding, pulverization (as in the case of talc), or fine pulverization, is a mining process and should be allowed, particularly where the processing makes no change in the physical or chemical characteristics of the mineral or ore, except for its size.

3. The Secretary also proposes a new paragraph 4(B) that "Notwithstanding any other provisions of this subsection, any treatment process which follows a process that is not considered as 'mining' will not be considered as mining for the purpose of this subsection." The sequence in which mining processes are applied should not be determined by tax considerations. The interjection of an unallowable process, if economically sound, should not serve as a cutoff point resulting in disallowing processes which the Treasury Department would otherwise recognize as constituting mining.

Each member of the sand and gravel industry must develop a program of processing which will produce, in his case, a product of high quality which will serve the interests of his market. There is no uniform practice in our industry with respect to the order of processing. Ours is an industry which is constantly undergoing changes to reflect new technology and newer and more rigid specifications for sand and gravel of acceptable quality. The producer must adapt himself to these changes and in doing so, he may find it necessary to modify his processing operations. It would be contrary to the public interest if he were required to adapt his operating processes to the rigid language of the statute. We hope that your committee will reject this phase of the Secretary's proposal.

CONCLUSION

We therefore respectfully request the committee to make it clear in the proposed bill that a process specifically referred to as admissible will not be disallowed because of the intervening of unallowable processes. We also respectfully request, in the interest of administrative clarity and in the interest of avoidance of expensive and protracted litigation, that pulverization, including fine pulverization, be specified as "mining" and that the committee retain the current test in the Internal Revenue Code, for application to all mining industries, of "commercially marketable mineral product or products * * *."

IDEAL CEMENT CO.,
Denver, Colo., March 12, 1959.

Hon. WILBUR D. MILLS,
Chairman, Committee on Ways and Means, New House Office Building, Washington, D.C.

MY DEAR MR. MILLS: I have just had an opportunity to read the statement presented to your committee by Mr. Boyce F. Martin of Louisville, Ky., on behalf of 38 companies representing some 70 percent of the capacity of the cement industry in this country. Mr. Martin expressed the opposition of these cement pro-

ducers to the Treasury Department's proposal to redefine the term "mining" for the purpose of computing the percentage depletion allowance.

In order that your committee may be fully informed on this important matter, I want to make it clear that Ideal Cement Co. is one of the companies not represented by Mr. Martin, and that we do not subscribe to the views expressed in his statement. Instead, we agree with the views expressed by the American Mining Congress in their statement presented by Lincoln Arnold before your committee on March 5. Specifically, we concur in the Treasury's recommendation that the "marketability" test be eliminated for the future, in order that the percentage depletion concept may be continued on a sound and reasonable basis. We wish to emphasize, however, that we take this position only on the basis of the assumptions outlined in the statement of the American Mining Congress; and we particularly urge that a specific provision be included in the new legislation making it clear that the term "mining" shall include:

"* * * in the case of calcium carbonates, shale, and other minerals used in making cement—all processes used in the production of the kiln feed."

The need for such a provision as outlined in the statement of the American Mining Congress was also clearly recognized in the testimony of David A. Lindsay, which he gave on March 5 on behalf of the Treasury Department.

In addition to Ideal Cement Co., I am informed that at least two other major producers of cement also concur in the position taken by the American Mining Congress and urged by the Treasury Department. These three producers account for approximately 20 percent of the capacity of the cement industry in this country.

It is requested that this letter be made a part of the record of the hearings currently being conducted by the Committee on Ways and Means on this subject.

Respectfully submitted.

CRIS DOBBINS, *President.*

The CHAIRMAN. Our next witness is our former colleague, a former member of the Ways and Means Committee, the Honorable Wesley E. Disney.

We are indeed gratified to have you with us this morning, Mr. Disney. We always look forward to your return to the committee. We welcome you back. You are recognized.

STATEMENT OF WESLEY E. DISNEY, ATTORNEY

Mr. DISNEY. I am not going into the Treasury proposals in detail. That has been done by so many other witnesses that it would have a tendency to tire the committee.

We are opposed to the Treasury bill for the reason that it would discard the test of percentage depletion as it is known as the ordinary treatments processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products. The Treasury substitutes for that an ill-defined formula—if it can be called a formula—that instead of simplifying the situation would make it more complex than it is, a good deal more. It would make a confusion worse confounded.

It was said by the Treasury that there would be a great tax loss unless the situation is remedied. Let's take a look at the tax loss. As stated, the loss merely represents the difference between what the courts have held that Congress by statutory regulations has provided for depletable industries, and what the Treasury from the viewpoint thinks industry ought to receive, and it is proverbial that Treasury's estimates have always been exaggerted in their favor.

I have seen that so many times before the committee here, that the Treasury brings its measures in to suit itself. Why does the Treasury desire to interfere with the orderly processes outlined by Congress and in effect for years?

Why, if the cement industry and the brick people are out of line, not attack them head on and ask for legislative action on their cases and let the rest of us alone? They have plenty to say in their defense and are ready to say it.

Why should the rest of the mineral industry have to come and defend themselves and the statute Congress has passed, and otherwise has worked satisfactorily for years, except that Treasury has continually found fault with it and has sought to change it. At an ensuing session you can depend on Treasury, if this bill is passed, to come in with an amendment to this very bill they now espouse.

You are losing out on a theory that has been tried out very thoroughly by Congress and then by the industry itself.

The American Mining Congress has adopted the Treasury's proposal, after working with the present statute for years. But look at the mining congress statement and you find that on every page it suggests some change or amendment, indicating the numberless problems that would confront the Treasury and the courts in attempting to work under their proposal. That, while bad enough, making us go over the whole depletion situation anew, is not the worst vice in the mining congress position. It throws out, as does the Treasury, the formula under the present statute, and puts the mining industry to work on a new statute with its attendant uncertainties, vexing to the industry as well as Treasury, that are provocative of more and more lawsuits.

What good can come of it? Less depletion for deserving industries and more favoritism for others. In order to get one or two bad rats, they would burn down the whole barn of depletion. In order to get rid of two bad rats, they have burned down the whole barn of depletion.

The courts have almost always ruled against the Treasury. The courts have almost uniformly held that the industry has conformed to the statute. Why disturb a situation that has worked well for the purpose it was intended and for the industry it was intended to assist? Why change it? Why not leave it as it is, or at least confine the amendment to the abuses complained of by the Treasury?

We do not ask for depletion as a manufactured product, and from the Treasury statement we may get the same treatment that we have always had in the granite industry, but we do claim our right to depletion on the mining and preparing for shipment, such as sawing and polishing. Not a thing even approaches manufacturing in the sawing and polishing of granite. It is logical to have depletion on the stone as sawed up into shape so that it would sell. Mr. Lindsay, when first asked about this matter, said sawing and polishing was cut out by the present bill. Later he was queried about the same matter and his answer was that under the Treasury bill mining included sawing and polishing. You will remember Mr. Ikard bombarded him again with those questions.

This illustrates the hazy consideration of their bill by the Treasury and the lack of information going to the point at issue. Who is best fitted to know what to do, a man whose business life is involved or the man who has a theoretical view of the subject?

Likewise, as to polishing, the granite will not sell in many instances unless this process is applied. Who would refer to this process as manufacturing? Yet the bill provides that polishing and sawing of

granite is not mining. The granite is not changed so as to make it subject to the claim that it is manufactured, but its appearance is changed.

We are opposed to the bill offered by the Treasury for the reason that it discards the test-of-treatment process ordinarily used by the miner in order to make his product marketable. That test has been ordinarily used by the miner with some satisfaction and to the dissatisfaction of the Treasury for more than 10 years. It has been worked on by the courts, and they are coming to apply this statute as it was meant to be applied. With the new proposal by the Treasury, we will have to start again to hew out the path that is clear today, with the two exceptions, and there is a way to meet their case if you decide to do it.

This bill ought to be killed here where it started. We ought to encourage business to progress. We ought to help by letting well enough alone when we know it. If by any chance you do make a favorable report on this bill, you should add to it as an amendment the following:

Following 3(D), add the words "and the processing of granite" and that will clear up what argument was put in by Mr. Ikard and the Treasury witness. By no means should we make the bill retroactive.

The CHAIRMAN. Are there any questions of Mr. Disney?

Mr. Disney, we are always helped when you return to the committee to advise with us on these problems that we have before the committee. We want you to know that we appreciate very much the presentation of your viewpoint this morning.

We thank you, sir.

Mr. DISNEY. Thank you.

The CHAIRMAN. The next witness represents the Potash Co. of America, Mr. F. O. Davis.

Mr. Davis, please identify yourself for the record and identify your associate.

STATEMENT OF F. O. DAVIS, PRESIDENT, POTASH CO. OF AMERICA; ACCOMPANIED BY JOHN T. SAPIENZA, ATTORNEY AT LAW, WASHINGTON, D.C.

Mr. DAVIS. I am F. O. Davis, president of the Potash Co. of America, and my associate is Mr. John T. Sapienza. Our company is located in Carlsbad, N. Mex.

I appreciate the privilege of appearing before your committee and giving you my views on the Treasury proposal to specify the treatment processes to be allowed in the computation of percentage depletion for mineral products.

As a preliminary statement, and a guide to the remarks which follow, I wish to advise that this presentation is not in opposition to the general purpose of the Department of the Treasury whereby it seeks to clarify the term "mining" for the purpose of computing percentage depletion in the case of minerals and ores. It is fully as important for the mine owner or operator to know, clearly and unequivocally, what treatment processes are considered as mining as it is for the Department.

Unfortunately, however, it appears that in the endeavor to insure restrictions against possible unreasonable claims, certain definitions and descriptions are proposed which can only result in the continuance of the ambiguity which the Treasury seems to believe exists in the present statute, and which retain the basis for differences in interpretation by and between the taxpayer and examining agents of the Internal Revenue Service. It is felt that these areas should be clarified to avoid future confusion, litigation, or delays in review procedure. The modification which I believe is necessary and desirable will be suggested a bit later in this statement.

My company is a mine operator, located near Carlsbad, N. Mex., producing a primary product through a combination of the treatment processes recommended in the Treasury proposal. It does not produce any material on which it could secure, under any interpretation, a severalfold increase in the depletion deduction, as described by the Secretary of the Treasury in his letter of January 26, 1959. The market for its output is at a primary level, with the product going either to fertilizer mixers or to industrial processors, and any subsequent enhancement in value after the mineral has received its primary processing is not subject to percentage depletion. The general basic treatment processes and procedure used by my company are, to the best of my knowledge, common to all potash mine operators.

Potash is the commonly used and generic description given to the mineral potassium, and the mineral is so classified in section 613 of the Internal Revenue Code. The ore or mineral occurs in a variety of forms, the most common being potassium chloride and potassium sulfate, but for the purpose of this statement the mineral will be referred to as potash, inasmuch as the problems relating to treatment processes are common to the various forms of the mineral.

Potash, in the form produced by mine owners and operators throughout the United States, is a low-value mineral which must move great distances to find a market. The major part of potash consumption in the United States, aggregating several million tons annually, is east of the Mississippi River whereas the production is in the Far West. About 90 percent of domestic potash production is used in commercial fertilizers and the balance is used in numerous industrial operations. Competition of the domestic producers is mainly from European sources and a substantial part of requirements at eastern seaboard is supplied from these imports.

The major point of concern in the Treasury proposal occurs in subparagraph (3)(C) where the treatment processes considered as mining are described. This section, together with the exclusions in subparagraph (4)(A), would result in retaining the uncertainty or obscurity which the Treasury claims is currently inherent in the statute. The proposal suggests a degree of separability and exclusiveness which is impossible in any treatment process. For example, subsection (3)(C)(iii) covers "beneficiation by cyanidation, leaching, crystallization, or precipitation, and the processes necessary thereto." This description, by use of the word "or," indicates a choice of the enumerated functions and not a combination of the named processes. Thereafter, in substance (4)(A), a proposed disallowed process is "thermal action" without any further description of "thermal," which, in its simplest definition merely pertains to heat. There are very few treatment processses which do not require drying as one of the functions and certainly this is true of any process using water.

The drying of a processed product would be excluded if thermal action is excluded. The same is true of any function requiring the introduction of steam.

Probably the most elementary type of treatment or beneficiation would be to leach an ore, and to precipitate the contained mineral, thereafter to remove the precipitated mineral by filtration or centrifuging, and then to dry the resultant cake of mineral by some type of dryer utilizing thermal action.

A more common type of treatment process could employ several of the processes described in subparagraph (3) (C), together with thermal action, as drying, in order to remove, in its most basic form, the mineral contained in the ore. It may appear captious to suggest the possibility that the Internal Revenue Service or an examining agent of the Internal Revenue Service would say that only one of the described treatment procedures could be utilized, or that drying a filtered material constitutes thermal action, but this is exactly what was suggested in the course of an examination of the returns of my company.

The importance of having a tax law which can be understood and uniformly administered is made clear in our recent tax history. My company now has 7 open years, acceptance or modification of the returns having been held up because the language concerning presently allowable treatment processes considered as mining has been subject to varying interpretations by the Treasury. An audit was started 4½ years ago, covering the 3 earliest years, but several matters remain unresolved.

In the past 15 years, during which potash has been covered by percentage depletion, we have had several different examining agents. Each has viewed the treatment process problem, or the sales value problem, in a different manner. The regional director's office, in order properly to interpret the act has found it necessary to request rulings from the national office. The Internal Revenue Service 2 years ago ruled exactly opposite from what it had ruled 10 years previously on the same product and the same set of facts. Two agents from our regional office (one succeeding the other due to a promotion of the first agent) have used different approaches and arrived at different answers to the same depletion problem. One of these agents, because of then pending litigation covering other minerals, had to wait 21 months to get a ruling from the national office and in this period all action in our case was held in abeyance. During all these periods of examination and delay our company continued to give waivers at the request of the Service.

Our company not only was and is subject to continuing interest in case of the assessment of a deficiency but it had, and still has, no guide concerning treatment of subsequent returns. With the corporate tax as its present level, a delay of this sort imposes a hardship and creates an untenable position as it is virtually impossible to determine what type of tax reserve should be established.

Unless confusion is eliminated under whatever type of value concept is adopted, we can expect a continuation of this type of delay.

The treatment procedure in the case of potash is relatively simple but, nevertheless, many processing steps are required to eliminate the waste. The commonly used steps, after the ore is crushed and screened, are some type of washing or leaching, tabling (concentra-

tion by gravity), flotation, precipitation, crystallization, drying, screening, and amalgamation of extremely fine particles are all part of an integrated treatment procedure and are all for the purpose of recovering the basic mineral from the ore. No one mine operator or owner necessarily uses all of the foregoing treatment processes at one time or place, but every potash miner operator uses at all times several of the treatment processes in combination.

It is realized that a separate treatment process description cannot be provided for every mineral but the characteristics of potash are different from most minerals. It is a soluble material and the waste material from which it is separated is also soluble. The processes applicable to metals or most other minerals do not generally apply to potash. It has been found necessary in the Treasury proposal to carry separate criteria for coal, sulfur, and certain other minerals because of their distinctive features and if a specific treatment process definition could be incorporated for potash it is felt that administration of the statue will be simplified and differences of opinion eliminated. It is suggested that the following language be incorporated in the act following the proposed section (3) (B) covering sulfur:

( ) IN THE CASE OF POTASH.—Crushing and screening of ore, washing, leaching, tabling, flotation, precipitation, crystallization, drying, screening, amalgamation of fine material, or some combination of these processes or other processes which produce substantially equivalent results, and loading for shipment.

It will be noted that the processing functions listed above do not produce results different from those obtained by the processes proposed by the Department of the Treasury. The description of permissible treatment processes is merely gathered at one point. The proposal made herein is for the purpose of complete clarity and to give recognition to two facts: First, that several of the functions must be used in combination, and second, that no new processes producing substantially equivalent results will be excluded.

If a clear and unambiguous listing of the treatment processes considered as mining is available to the potash mine owner or operator then both the Treasury and the taxpayer know in advance what can be expected.

In the Treasury Department's proposal, as covered in paragraph (3) (C), the sole measure as to the point of cutoff is the elimination of waste or the physical condition which permits the product to be shipped. Naturally, the elimination of waste is undertaken for only one purpose—to make the product marketable. Shipping of the product is also undertaken for one purpose only—to serve a market. Consequently, if the commercially marketable test is to be superseded, it is highly important that the processing functions be broadly enough defined to permit the marketing of the mineral product or products as contemplated by the Congress over the years or the entire purpose of percentage depletion has been defeated and its concept changed.

I have noticed over the past few days several questions that have been addressed to the witnesses asking their preference between the old basis and the proposed basis, and I would like to at this point interpolate with a paragraph covering that.

The existing commercially marketable mineral product test is satisfactory and desirable insofar as we are concerned. We would not feel that such an amendment as we have proposed should be adopted

if the commercially marketable mineral product tests obtained. However, if it should be the desire of this committee to substitute a form of percentage depletion base patterned on the proposal of the Treasury Department, it would then appear not only desirable but probably necessary to designate a combination of treatment processes such as I have proposed in order to avoid endless controversies in the future and in order to properly effectuate the desirable purposes of the percentage depletion section of the code.

I would also recommend deleting paragraph (4) (B) of the Treasury proposal. This paragraph would disqualify any treatment process which follows a process that is not considered mining, even though such treatment process is specified in the law as a mining process. We can see no reason for disallowing a mining process simply because it follows another process which is not mining. Such a rule would prevent taxpayers from organizing their processing in the most economic manner or in a logical sequence. There should be no need for such a rule if the mining processes are fully described in paragraph (3).

Mr. Chairman, I appeared here for our company alone but as a matter of information to myself and courtesy to other potash producers in the country I made available to them a copy of the statement in the latter part of the week.

Unfortunately, there has not been sufficient time to have heard from all, although I did ask that they try to advise me either of their concurrence in or disapproval of my statement.

I have received endorsements from four other companies, the United States Borax & Chemical Corp., which operates as United States Potash Co., in Carlsbad, International Minerals & Chemical Corp., which operates also in Carlsbad, and National Potash Co., located in Carlsbad.

Incidentally, about 90 percent of all potash in the country is produced in New Mexico.

All of these support the proposed description which I have given. The companies involved represent something in the neighborhood of 70 percent of the total potash production of the country and I would like to submit these for the record to show that there is that unanimity of opinion.

The CHAIRMAN. Without objection, those statements will be included at this point in the record.

(The documents referred to follow:)

TELEGRAM FROM NEW YORK, N.Y., TO F. O. DAVIS, WASHINGTON, D.C.

Pleased to advise you that United States Borax & Chemical Corp. endorses and approves the proposed amendment which you are offering to subsection 3 of section 1 of the depletion provision affecting minerals and as proposed by the Treasury Department.

GIDNEY.

TELEGRAM FROM SKOKIE, ILL., ADDRESSED TO FRED DAVIS, PRESIDENT, POTASH COMPANY OF AMERICA, WASHINGTON, D.C.

Approve your amendment to Treasury proposed legislation affecting Internal Revenue Code section 613 suggest it be carried further to give the so-called sudden death clause proposed by Treasury the same treatment being given it by American Mining Congress.

C. M. EDWARDS,
International Minerals & Chemical Corp.

LETTER FROM NATIONAL POTASH CO., NEW YORK, N.Y., DATED MARCH 6, 1959

Mr. F. O. DAVIS,
President, Potash Co. of America,
Washington, D.C.

DEAR MR. DAVIS: In connection with your appearance before the Ways and Means Committee of the House of Representatives on the matter of percentage depletion, you were kind enough to supply us with a copy of the amendment to the Treasury proposal which you plan to submit. We are most anxious to lend our support to your proposed amendment and to express our wholehearted approval of what you are trying to accomplish. We feel that unless the proposed legislation is clarified as to treatment processes for potash that may be considered as "mining," the legislation proposed by the Treasury would leave our position in this matter uncertain to a degree which would be to the disadvantage of both the industry and the Treasury Department.

Please accept our best wishes for every success in your effort.

Very truly yours,

ALBERT F. ROTHWELL,
Secretary and Treasurer.

LETTER VIA SPECIAL DELIVERY FROM SOUTHWEST POTASH CORP., NEW YORK, N.Y., DATED MARCH 6, 1959

Mr. F. O. DAVIS,
President, Potash Co. of America,
Washington, D.C.

DEAR MR. DAVIS: You have advised us of the amendment, which you propose to submit, to the Treasury proposal being considered by the House Ways and Means Committee on percentage depletion. This will advise you that we wholeheartedly approve of the amendment which you propose to submit and that we earnestly hope that you will be successful in gaining congressional support for it.

Very truly yours,

SOUTHWEST POTASH CORP.,
F. H. STEWART,
Vice President.

Mr. DAVIS. I shall then be glad to endeavor to answer any questions the committee may have.

The CHAIRMAN. Are there any questions of Mr. Davis?

If not, Mr. Davis, we thank you, sir, for bringing your viewpoint and the viewpoint of the others mentioned in the statement to the committee this morning on this subject.

Thank you, sir.

Mr. DAVIS. Thank you.

The CHAIRMAN. Our next witness is Mr. Richard S. Kitchen.

STATEMENT OF RICHARD S. KITCHEN, CHAIRMAN, COMMITTEE FOR OIL SHALE DEVELOPMENT, DENVER, COLO.

Mr. KITCHEN. Mr. Chairman and members of the Ways and Means Committee, my name is Richard S. Kitchen. I am chairman of a citizens' organization known as the Committee for Oil Shale Development. This statement is presented on behalf of that committee and is joined in by former United States Senator from Colorado, Edwin C. Johnson, who could not be present with us today in person.

We wish to thank you for the opportunity to present our point of view with regard to the recent proposal of the Treasury Department to amend the Internal Revenue Code regarding definition of ordinary treatment processes in the case of percentage depletion.

As stated by Mr. Lindsay last Thursday before this committee, it is the intention of the Treasury Department in presenting this amend-

ment to overcome the effect of certain recent cases primarily dealing with cement and clay and other nonmetallics.

Perhaps unintentionally, the proposed amendment would, in our opinion, so limit the application of the depletion allowance to oil shale as to make it almost worthless as an incentive to the development of this industry. Thus, if this proposal in its present form is enacted into law, it would mean that the development of the oil shale industry, which should commence in the near future, will not materialize. This will result in a loss to our economy of an estimated annual payroll of about $410 million, representing 63,000 new jobs. A city of one-quarter million people based upon oil shale development activities will not materialize, and tax revenues of almost three-quarters of a billion dollars per year to be generated by such an industry will not be realized.

Most important, this valuable domestic source of oil would not be readily available in the event of war. Under present conditions, the United States is becoming increasingly dependent upon foreign supplies of petroleum; this situation threatens to become increasingly worse. By enacting legislation which would effectively discourage the development of our domestic oil potential, Congress would be subjecting the Nation to grave risks in the event of war.

We wish to describe to you today, first, the oil shale potential of the country; second, the history and present status of development; third, the technology involved in producing shale oil; and, finally, the tax status with regard to this mineral.

Last year we presented to this committee testimony of numerous individuals, headed by former U.S. Senator Edwin C. Johnson, of Colorado, with regard to the oil shale industry. At that time we urged this committee to grant to the industry a depletion allowance equal to that of other oil producers and to establish by law the processes which would be considered ordinary treatment processes for the purpose of computing percentage depletion.

This proposed legislation now before you would have the effect not only of denying equal treatment to the oil shale industry with regard to the rate of depletion granted but would make the depletion allowance almost worthless regardless of what rate is applied.

The most significant deposit of oil shale in the United States is known as the Green River Formation, which is located in the States of Utah, Wyoming, and Colorado. It covers an area of approximately 16,500 square miles, including 2,600 in Colorado, 4,700 in Utah, and 9,200 square miles in Wyoming. That portion of the Green River Formation occurring in Colorado's Piceance Creek Basin and, specifically, the rich substrata known as the Mahogany Ledge is currently of greatest economic interest. However, it should be borne in mind that reasonably good deposits of oil shale are found to exist in the Chattanooga Formation of Indiana, Ohio, Kentucky, Tennessee, and other neighboring States.

Getting back to the Green River Formation, it is estimated by the U.S. Geological Survey that the total potential oil content (without allowance for production losses) is in excess of 1.5 trillion or, in other words, 1,500 billion, barrels of oil. This can be compared to recent estimates of U.S. proven conventional petroleum reserves of someting less than 33 billion barrels and total free world proven reserves of approximately 207 billion barrels. About one-half of the Mahog-

any Ledge area is the property of the U.S. Government, 10 percent of which is set aside as a petroleum reserve for the Navy. Thus, it can be seen that the development of this reserve would result not only in a tremendous new tax source but also in a direct source of revenue to the Government by leasing or other disposition of its vast holdings.

The oil shale itself in the Green River area is a laminated rock formation containing a bituminous substance known as kerogen. The kerogen is released from the rock in the form of low-gravity oil and combustible gas by the means of application of heat. It should be emphasized here, for this is the most important point to understand, that there is no known way of extracting the kerogen from this rock other than by the application of heat.

Reacting to the shortage of domestic petroleum during World War II, Congress adopted the Synthetic Liquid Fuels Act of 1944. Under this act, the Bureau of Mines expended over $17 million developing practical mining methods, including methods of extracting liquid fuel from oil shale. The Bureau established the fact that large-scale conventional mining methods (specifically the room and pillar method) could be used. Further, it constructed between 1950 and 1955 three pilot plant models of a retort to extract the oil from the shale. The largest model operated successfully at rates in excess of 200 tons per day.

Private industry also has been experimenting with various types of mining and retorting. The Sinclair Oil Co. carried out experiments in heating the rock in place, with undisclosed results. The Denver Research Institute is conducting tests of a Swedish design for the Oil Shale Corp., and the Union Oil Co. of California has built and operated a pilot plant in the shale-oil mountains near Grand Valley, Colo., at a total expenditure of almost $10 million. The Union Oil pilot retort had an estimated initial capacity of about 375 tons per day of crushed ore, but actually was operated at capacities far in excess of that figure. So it is apparent that large sums have been expended upon developing the technology of shale oil; that this is not merely a dream of possibilities for the future, but that an oil-shale industry to be developed in the near future is an actuality upon which private industry has been willing to risk substantial sums.

However, in order to develop an industry capable of producing 1 million barrels of oil per day, it has been realiably estimated that capital expenditures in excess of $7 billion will be required. Now, this amount of money cannot be secured unless and until equitable tax treatment is granted by Congress.

The industry will probably start with an installation of a plant of about 20,000 barrels a day, which would cost in excess of $125 million. This plant would then be expanded as funds became available. The depletion allowance, being designed as a measure for recovery of capital, could and should be the principal source of securing the needed capital for expansion. It is also apparent that even if a crash program were instituted today it would be at least 5 years before a production figure of 1 million barrels per day could be reached. In view of the fact that the United States is now consuming more than 1½ million barrels per day from foreign sources, it is obvious that, if we are not to be caught short in the event of war, this industry should be encouraged to commence and expand production at the earliest possible time.

We have referred before to the fact that the only known means of extracting the bituminous substance, kerogen, from the rock is the application of heat. While the Atomic Energy Commission and the Bureau of Mines are now proposing to experiment with atomic explosions in the oil-shale formations, the present-day technology indicates that the most probable method of obtaining oil from the deposit will be to mine the rock, crush it, and run it through what is known as a retort.

There are various types of retorts; in fact, there are 2,000 patents relating to them. However, they all involve a basic principle of heat exchange, whereby the shale is fed into what is essentially a furnace. As the shale passes through the heated zone, the kerogen decomposes and vaporizes. In other words, the kerogen changes from a solid form to a gas or vapor. The vapor contains a vaporized liquid product which is shale oil and a low B. t. u. gas. The vapor is then drawn off and the shale oil captured for further processing, while the gas may be marketed directly for industrial purposes or used again in the retort as a heating agent.

These retorts will be located on the side of the mountain directly at the mouth of the mine and can be compared closely with the mills installed at hard-rock mining operations whose function is to extract the metallic metals from the ores or waste in which they are contained. Similarly, kerogen is extracted by means of a retort from the shale rock, which is then discarded as spent shale.

The shale oil as it comes from the retort is comparable to a low-gravity crude with a very high viscosity. It is a jellylike substance at room temperature, but is the first product which has characteristics similar to that of petroleum. It is at this point which we feel the cutoff should be applied, so that the retorting, which we have just described, will be included as an ordinary treatment process for the purpose of computing percentage depletion.

After this product of the retort is obtained, further upgrading is necessary before the oil can be placed in pipelines or otherwise moved toward market. However, in this respect, the retorted oil is no different from high-viscosity, low-gravity fuels now produced, for example, from the many wells in California. These further processes are known as coking and hydrogenating. I mention them because it is interesting, in passing, to note that this industry will produce from these further processes large amounts of valuable byproducts. It is estimated that an oil-shale industry producing a million barrels per day of oil would also produce 1,840 tons a day of ammonia, 860 tons per day of sulfur, 23,600 tons per day of coke, plus a staggering amount of fuel gas—an amount which would approximate the total power production of Hoover Dam.

Current opinions with regard to the application of section 613 of the Internal Revenue Code to oil shale are to the effect that oil shale will presently be allowed a depletion allowance of 15 percent, but the present law does not clearly spell out processes which will be included as ordinary treatment processes. The proposal of the Treasury Department does not enumerate retorting as a treatment process considered as mining under section 613(b)(3)(C) and in section 613(b)(3)(4) excludes "treatment effecting a chemical change" and "thermal action." We feel that these exclusions would prevent retorting from being considered as "mining" and would confine computation of

the percentage depletion allowance to the stage at which broken rock is hauled from the mine. In other words, the depletion would be computed upon merely the cost of delivering the broken ore to the retort, plus some allocation of profit. This would be a very meager depletion allowance compared to a computation upon the retorted product and would serve as practically no incentive to the development of this vast resource.

As a matter of fact, since the Treasury proposal includes "washing" and "beneficiation by concentration" for the "purpose of eliminating waste" as mining, it appears likely that such other potential sources of petroleum reserves as tar sands would enjoy a much more favorable depletion allowance than that of oil shale. Thus the vast tar sand deposits of Canada would probably, by this proposal, be given a tax preference over our domestic potential of oil shale.

The situation we have referred to can be cured by a very simple modification of section 613(c)(3)(D) of the code as the Treasury would propose to amend it by section 1(b)(3) of the Treasury bill.

We suggested the insertion after the phrase "the furnacing of quicksilver ores," the phrase "retorting or substantially equivalent treatment of oil shale." Thus subparagraph (D) would read as follows:

(D) The pulverization of talc, the burning of magnesite, the furnacing of quicksilver ores, the retorting or substantially equivalent treatment of oil shale, and the sintering and nodulizing of phosphate rock.

This particular subsection is the logical place to insert our proposed language, because the retorting of oil shale and the reaction which takes place is substantially identical to the furnacing of quicksilver ores. In each case, the ore (oil shale or cinnabar) is passed through a retort or furnace in which hot gas acts as a heat exchange to increase the temperature of the ore and decomposes the product-containing compounds which are kerogen or mercuric sulfide. While there is a chemical change, this is the only method of separating the product-containing compounds. This thermal decomposition causes the kerogen or mercuric sulfide in the ore to change from a solid to a vapor or gas. The products are: A vaporized liquid product (shale oil or mercury); gaseous materials; and residual spent material. The vaporized liquid product (shale oil or mercury), is drawn off, condensed and collected as a liquid. Therefore, we are asking for no more as a mining process than that which is specifically provided by the present statute as well as by the Treasury's new proposal in the case of mercury and is in concept the same as that provided in the case of ordinary metal mining, to wit: the extraction of the mineral from the worthless remainder of the ore.

We have with us today a set which most of you saw displayed here in the hearings last year but which we wish to use again as an illustration of the points made today.

I will pass this up if any of you wish to see it.

First, we have a jar containing crushed rock as it is delivered to the retort.

Second, we have a jar which contains the low gravity and high viscosity shale oil that is produced from the retort.

You will notice that this product will not flow at room temperature. It is at this stage that we proposed to compute our percentage depletion allowance, that is, after we have obtained the material we are seeking, namely, the shale oil locked up in the oil shale.

After the retorting stage, as mentioned previously, further upgrading takes place by means of coking and hydrogenating. Here is a bottle containing oil as produced from the coker and, next, an amber-colored oil as it is then produced by the hydrogenator. This coked and hydrogenated oil is the equivalent of a very high-grade crude oil, which is then refined into various petroleum products.

The next jar is a diesel fraction produced from shale oil and, finally, a jar which contains jet fuel, which conforms to the specifications of the U.S. Navy for JP–4 jet fuel.

We feel that, in asking for the establishment of retorting as treatment process considered "mining" under the new Treasury proposal, we are making a reasonable request, especially in view of the additional processes which must be undertaken in order to render the shale oil equivalent to petroleum and place it in the pipe line. Our proposal is in line with the Treasury proposal relating to the La Gloria case in applying depletion "in the vicinity of the well." Shale oil is the mineral we are seeking and is obtained by retorting in the immediate vicinity of the mine. We believe that at least the retorting step must be included in order to have a depletion allowance of any significance whatever and to place the oil shale industry in the same position as other competing fuels. While we also believe that the rate should be the same in order to insure the development of this industry, we are convinced that, regardless of the rate, the cutoff point must be after the retorting stage.

In summary, we have pointed out the shortage of domestic oil supply, the existence of a vast shale oil potential and the fact that this potential cannot be realized wihout an equitable depletion allowance. We have suggested a modification of the Treasury bill to include retorting of shale oil within the definition of mining. This action would be completely consistent with treatment of other ores under the present code, present Treasury regulations and the proposed Treasury bill. Our proposal will not cost the Treasury one cent but may lead to the development of a new industry vital to our economy in time of peace and to our safety in time of war.

We hope you will give our suggested modification serious and favorable consideration.

Again, we wish to thank you for this opportunity to present our views to this committee, and we will be happy to furnish any additional information that you may desire on this subject.

The CHAIRMAN. Are there any questions of Mr. Kitchen?

Mr. MASON. I have one question, Mr. Chairman.

The CHAIRMAN. Mr. Mason will inquire.

Mr. MASON. That first product, that heavy black product will be on the basis of the raw petroleum that comes out of the well?

Mr. KITCHEN. Yes, sir. This first product, while it will not flow at room temperature, is very similar to the high viscosity black stuff that is produced from wells in California.

Mr. MASON. That is all, Mr. Chairman.

The CHAIRMAN. Are there any further questions?

If not, we thank you, Mr. Kitchen, for presenting to the committee the views which you have presented this morning.

Mr. KITCHEN. Thank you.

The CHAIRMAN. Our next witness is Mr. J. W. Roberts.

Mr. Roberts, please identify yourself for the record by giving us your name, address, and the capacity in which you appear.

STATEMENT OF JOHN W. ROBERTS, PRESIDENT, SOUTHERN LIGHTWEIGHT AGGREGATE CORP., RICHMOND, VA.

Mr. ROBERTS. Mr. Chairman, my name is John W. Roberts, and I am president of the Southern Lightweight Aggregate Corp., which directly, and through subsidiaries, is engaged in the business of mining and producing a lightweight aggregate known as "Solite." Our first plant was established in Virginia in 1947, and since then we have established three other plants, one in North Carolina, one in Florida and one in another section of Virginia, and our productive capacity has been increased more than sevenfold.

The mineral we have been using in the production of Solite is a type of slate for which there is no commercial market in its raw state. It is exceedingly difficult to find deposits of a mineral suitable for our use, and we have been able to locate them only after extensive and expensive explorations. Before we were able to locate the first deposit of suitable material, we investigated 46 deposits within a 3-State area. Our subsequently acquired deposits were found only after extensive explorations and investigations in practically every State east of the Allegheny Mountains.

The principal process used in the production of Solite is a thermal process, the raw mineral being placed in kilns, where it is expanded under high temperature. Solite is not an end product. It is an aggregate used generally in the production of concrete products such as structural concrete, roof slabs, building blocks and other building units. Through the use of Solite, by reason of its lighter weight, substantial savings in structural steel are effected. Other benefits accrue from Solite's high-insulating quality, inertness and durbility.

The expansion which has taken place in our own company during the past few yeads provides convincing evidence of the merit of, and demand for, our product. It has made a substantial contribution to many types of construction. In the housing field it is extensively used, many homes having been constructed with building blocks and other units made from Solite.

Let me mention just two projects, which are close at hand, in which Solite was used. In the reconstruction of the U.S. Capitol Building, Solite concrete was used for the roof slab, replacing a vermiculite concrete that had previously been used. It was impractical to use ordinary concrete there because the supporting structural members could not carry its great weight.

In the construction of the Chesapeake Bay Bridge, spanning 4.3 miles of open water, Solite concrete was used for the deck. The deadweight of the deck was thereby reduced more than 3 million pounds per mile, as contrasted with ordinary concrete, resulting in a great saving in structural and reinforcing steel.

The percentage depletion allowance of 5 percent which is given us under existing law has been of great help in enabling us to obtain the capital needed for our operations. Other lightweight aggregates are made from perlite, which is now granted a depletion allowance of 10 percent, and vermiculite, which is given a depletion allowance of 15 percent, and we feel strongly that we should receive a comparable depletion allowance.

If, as the proposed bill contemplates, the only processes taken into account were those relating to the extraction, removal, and crushing of the raw material, the depletion allowance to our industry would be so small as to be almost negligible. Certainly, it would not provide, as Congress intended, any incentive to undergo the great efforts and expense involved in the extensive exploratory work which must be done in order to locate suitable deposits. Moreover, the elimination of the thermal process would result in another gross inequity, inasmuch as a competing lightweight aggregate is produced from pumice and no thermal process is there involved.

Percentage depletion allowances with respect to oil and minerals have existed so long that it is felt unnecessary to indulge in any extended argument in justification thereof.

Such an allowance is manifestly not designed to enable the taxpayer to recover his investment in the mineral property. It is a deduction or incentive granted by Congress in furtherance of the national economy to encourage citizens to undertake the exploratory work and risks essential for the discovery and production of certain vital ores and minerals.

In Rabkin & Johnson, Federal Income, Gift, and Estate Taxation, section 46.06, it is stated:

> The most valid justification for percentage depletion involves a criticism of one of the underlying assumptions of our income tax. As a general rule, with capital gains the major exception, every type of income bears the same amount of tax; the tax varies with the amount of income but not with the degree of risk involved in creating it. The dollar earned in oil wildcatting would, but for percentage depletion, pay the same tax as the dollar earned on a 3 percent U.S. savings bond. The absurd surtax rates in the upper brackets are enough to discourage even mild speculation. The question is, How many persons would incur the extreme risks of oil drilling or mining exploration if the net rewards for success were as low as they would be in the absence of percentage depletion subsidy?

In dealing with the definition of "mining," the report of the Senate Finance Committee states:

> The purpose of the provision is to make certain that the *ordinary treatment processes which a mine operator would normally apply to obtain a marketable product* should be considered *as a part of the mining operation*, and to give reasonable specification of what are to be considered such processes for various kinds of classes of mines.
>
> The law has never contained such a definition, and its absence has given rise to numerous disputes. The definition here prescribed expresses the congressional intent of these provisions as first included in the law, and is in accord with the original regulations and the Bureau practices and procedures thereunder. It is therefore made retroactive to the date of such original provisions. [Italic supplied.] (S. Rept. 627, 78th Cong., 1st sess., pp. 23–24, 1944 C.B. 991.)

The underlying reasons for the definition contained in the present statute are just as valid and compelling today as when the definition was first adopted. Congress wanted to end the numerous disputes by adopting a simple, practical, and definite rule, which is susceptible of uniform and equitable application. The existing definition accomplishes the congressional objective, since, where there is a marketable product, there is a market price which can be used as a base for computing the deduction.

Under the proposed bill, it would be necessary to make an artificial, complicated allocation of income to the includible processes in order to determine the base to which the specified percentage is to be ap-

plied. In arriving at the base to be used, there is no logical reason why mining should be defined to include anything less than all the processes ordinarily required to obtain the first commercially marketable product. It must be remembered that the depletion allowance is not an allowance upon any process, regardless of its nature, nor is it an allowance upon any product obtained. It is an allowance designed to encourage the discovery and use of new mineral deposits. The present rule is a simple one, and the amount of the allowance in any industry can be easily controlled by increasing or decreasing the percentage rate. The proposed bill would substitute therefor a rule requiring complex mathematical methods and calculations in order to determine the portion of the gross income fairly allocable to certain processes.

There is a substantial difference in the nature and cost of the various processes involved in converting one type of mineral into a commercially marketable product and those involved in making such conversion of another mineral. By taking into account all the ordinary treatment processes, a common denominator is obtained in respect to all minerals. Manifestly, the formula prescribed in the present statute is not only the simplest but also the fairest one that could be evolved.

Notwithstanding the fact that the present statutory language seems perfectly clear and unambiguous in requiring the inclusion in gross income of the income from all processes normally applied in order to obtain a commercially marketable product, there has been a host of litigation dealing with the subject. Many thousands of dollars have been expended in setting at rest the various questions raised by the Internal Revenue Service in respect thereto. Based upon statistics furnished by it, on June 11, 1957, there were then pending 451 cases, involving the depletion allowances on 23 minerals, for the years 1951 through 1955. It would seem as unfair as it is unnecessary to substitute a new rule which would doubtless be productive of more uncertainty and a new round of litigation.

It is, therefore, apparent that if Congress feels that the percentage depletion allowance respecting any mineral should be reduced, it need only reduce the applicable percentage rate.

For the reasons stated, I feel that Congress should not enact the proposed bill, but should grant a depletion allowance for slate used for the production of a lightweight aggregate comparable to that given to vermiculite and perlite.

I wish to express my apreciation of this opportunity of appearing before you and stating my views.

The CHAIRMAN. Are there any questions of Mr. Roberts?

If not, Mr. Roberts, we thank you, sir, for bringing us your viewpoint.

Mr. ROBERTS. Thank you, sir.

The CHAIRMAN. Our next witness is with the committee on Federal taxation of the Mining and Metallurgical Society of America.

Please identify yourself by giving us your name, address, and the capacity in which you appear.

STATEMENT OF MAURICE E. PELOUBET, MEMBER, TAX COMMITTEE OF THE MINING AND METALLURGICAL SOCIETY OF AMERICA

Mr. PELOUBET. My name is Maurice E. Peloubet, a certified public accountant of New York City, as well as a member of the Mining and Metallurgical Society of America.

The Mining and Metallurgical Society of America is composed of mining and metallurgical engineers, geologists, and others interested in the engineering and scientific aspects of winning from the earth its minerals so they may be available for the use and benefit of mankind. Its members are individuals who have been elected as qualified for membership. It has no corporation or institutional membership and is in no sense a trade or business organization.

The society and its members have been and are deeply concerned with the discovery and development of new and improved processes and methods which more effectively and economically make the minerals available for use.

I think the committee might be interested in the composition of its tax committee: Lester J. Randall, of Wallace, Idaho, is chairman; Robert Page, president of Phelps Dodge Corp., is a member; Samuel Wilston, of the Fidera Mining Co., in Los Angeles, is a member; and the other two members, I think, are well known to this committee, Ellsworth C. Alford and Henry B. Furnell.

If it were not for the new and improved processes and methods developed in recent years, we would not have available our present mineral supplies for industry and for defense. Further developments must come in the future if we are to meet our future needs. A first point we would accordingly urge is that no legislation should discourage progress by denying to new processes and methods the treatment which is accorded to those now in use. Yet there seems a tendency in the proposed amendments to do this.

The short time within which we have had before us the Treasury proposals of February 11 has not been sufficient for the careful consideration of what may be the practical meaning and effect as they might apply to the many different circumstances and conditions which now exist and which we may expect to exist for various minerals.

We note that the Secretary in his transmittal of the proposed amendments has recognized that they require further consideration, particularly to make certain that appropriate treatment is given to all affected industries. We believe there is definite need for further consideration which we hope will be given and we hope the mining people may be given ample opportunity to participate in such consideration. This should be much more extended than these brief hearings permit.

The draft bill has seemed to us very uncertain in its meaning and very difficult of interpretation. We cannot present here all the points which may need further consideration, but some of the more important will be considered.

There does not seem occasion for any such radical rewriting of the definition covering those minerals which for over 25 years have been subject to percentage depletion and with respect to which standards,

practices, and procedures have long been established. If there are particular specifications or limitations which should be made applicable to some of the minerals later added, it should be possible to state these without need of such change as might void prior precedents. If there seems to be occasion for some changes in specification or limitation with respect to minerals long subject to depletion, these might be clearly and definitely stated.

Even where the same or similar wording is used with respect to processes to be considered as mining, other specifications of the proposed definition may affect their application and destroy existing precedents.

Perhaps the most potentially troublesome provision is subsection (c)(4)(B), the so-called sudden death clause. This provides that "notwithstanding any other provisions of this subsection, any treatment process which follows a process which is not considered as mining will not be considered as 'mining' for the purpose of this subsection." Apart from difficulties of administration and the disputes and litigation which can hardly help from arising under this provision, it is basically unfair and discriminatory. Two other witnesses this morning have already brought forward examples of these possibilities.

It eliminates processes otherwise treated as mining in one case, where these follow a nonmining process, and allows them in another. In this way a taxpayer might be heavily penalized for adopting an improved process, or even prevented from doing so.

Here again, I think Mr. Lindsay recognized that some modification might be necessary, and he brought forward the rather novel proposition that you can have a neutral process which is neither mining nor manufacturing. I do not quite understand it, but there it is. In any event, it seems clear that this needs a great deal more consideration and clarification.

Under present practice it occasionally happens that a "nonmining" process, where "mining" processes precede and follow it, is excluded from the computation without affecting the includibility of the remainder of the mining processes. The proposed provision is unfair and unnecessary, and it is recommended that it be eliminated from the proposed legislation.

The attempt to specify in subsection (c)(3)(C) in detail the processes which will be considered "mining" is ill advised without some general saving clause which will permit processes not now in existence and not even thought of to be included.

I am frankly, personally, quite disturbed about this checklist approach. I find it in other Government regulations, and it always makes trouble. We do not need a checklist. We need a sensible general guideline and the changes in wording where we say mining means something, instead of "processes or includible in mining" is an example of this.

Technological progress, while perhaps more spectacular in some fields such as electronics, plactics, and synthetic fibers is by no means limited to those fields. Furthermore, progress in one field is soon communicated to another. In mining, technological progress involves not only improved treatment methods but mining as well. The mining industry makes use of technological advances in, for example, the steel, chemical, rubber, and electrical equipment industries.

It is suggested that in order to avoid any interference with technological progress through the effects of rigid tax laws, the legislation should include some such language as "any of one or more processes which produce substantially equivalent results, so far as the particular mineral involved is concerned," some saving clause like that. The legislation should also make it clear that we are concerned with results rather than methods.

The general definition under subsection (c) (3) (C) which would be applicable to all minerals or ores other than coal and sulfur, and other than oil and gas wells, to which this definition is not applicable, is largely rewritten and raises many questions. It lists "beneficiation by concentration and the processes necessary thereto," then further limits this to certain purposes and to certain specified means "or substantially equivalent processes."

The use of the word "necessary" raises doubts. We could have processes that are appropriate and desirable but which could be considered not necessary.

The reference to "processes necessary thereto" may leave a question whether some processes may be necessary even though it may be conceded that they are appropriate and desirable and better concentration will result if they are used.

One example, which I believe has been brought to the committee before is "drying to remove."

Throughout the proposed subsection (c) (3) there is a tendency to use words which are unnecessarily limiting. For example, "drying to remove free moisture" should be changed to "drying to remove moisture." It would be most difficult to tell whether free moisture or inherent moisture was evaporated. In the description of beneficiation by concentration the word "solely" seems to be unnecessarily limiting, and some such expression as "primary" should be substituted. These are only examples, and subsecttion (c) (3) (C) should be examined with the greatest care by all concerned to be sure that the words and descriptions are not unnecessarily and perhaps unintentionally overrestrictive. There should be included in these processes which are given as illustrations of "beneficiation by concentration" contained in subsection (c) (3) (C), processes such as the "rosin-in-pulp" method, "ion exchange" and "solvent extraction." These are used in the concentration of uranium and are permissible under present practice. To avoid any controversy they should, therefore, be provided for in any proposed legislation.

For coal, as another example, there is the same mention of particular processes but there is an essential difference. In the present statute these constitute a nonexclusive illustrative listing of processes to be included. Under the proposed amendment there would seem to be an exclusive list and, even so, subject to possible disallowances under other provisions of the definition, including the specification that if any process not considered as mining is applied, any subsequent process, notwithstanding any other provisions of the section, will not be considered as mining. If the named processes are to be an exclusive list, there may be ground for much narrower interpretation of the scope of each particular process. For example, when "cleaning" was stated as merely one of the processes to be included, there was not the occasion for determining exactly what might be a "cleaning" process, whereas much might depend on definition if anything

which does not fall within the scope of that term or of some other specifically mentioned process were to be excluded. With respect to coal, there is not even the mention of processes incidental to or similar to those mentioned. Certainly if an exclusive list is to be given of all processes which may be considered as mining, the specification of those processes should be most carefully considered by those engaged in coal mining, with specific mention or adequate indication of other processes now in use and adequate provision made for new or improved processes which may be appropriately applicable in the future.

Similar statements could likewise be made with respect to other processes for coal or to the processes listed for other materials.

In subsection (c) (3) there is an ambiguity which might become serious if narrowly interpreted. The proposed legislation considers as mining nothing but the processes "applied by the mineowner or operator with respect to the minerals or ores extracted from the ground by him." Presumably the Treasury Department intends to exclude any treatment or processing of ores from the properties of others which, of course, is perfectly reasonable. If this is the purpose, then the section should be changed to read "applied by or for the mineowner or operator with respect to the minerals or ores extracted from the ground by him or for his account." If some change such as this is not made, the hiring of anyone by an operator or mineowner to do any part of his mining or processing, which is a common practice, might, by some misinterpretation, be excluded.

We all know that there is custom milling. We all know that there is diamond drilling and churn drilling which is contracted out. It is a very frequent thing.

The committee believes that the provisions of subsection (c) (4) (A) which would exclude treatment effecting a chemical change, thermal action, et cetera, "unless such processes are otherwise provided for in subsection (c) (3)" are ambiguous and undesirable.

Here again we have had some very good examples. I know a smelter in the northwestern part of this country where the winters are very severe and if the ore is transferred a few miles in transport it freezes and the cars are subjected to heat before they are unloaded.

I think it is a little ridiculous to call that a thermal process but maybe it could be called that.

Many processes involving chemical change or thermal action are mentioned in paragraph (3) (as many of them were recognized under Treasury practice when percentage depletion for mines was first allowed and have been specifically mentioned in the statutory definition). With this background, there is question of whether chemical change or heat treatment should be set up as ground for exclusion of processes, even though the exclusion be limited to cases not definitely covered by statutory mandate to the contrary. If, however, any such specification is to be included, there should be most careful consideration to be sure that all processes which should be included are adequately provided for in subsection (c) (3).

In subsection (c) (3) (C) provision is made in item (iv) thereof for additional processes, but limiting these to processes necessary to bring the ore or mineral to form and condition "capable of being trans ported" but not those "to make the mineral or ore salable". Presumably, practically anything is "capable of being transported" if sufficient expenditure is made to provide for such transportation and

sufficient time allowed. Mountains can be moved. To apply a test as to whether material is capable of being transported, regardless of cost of transportation or any economic incentive for its transportation, does not seem realistic and appropriate, and I think this is one of the sections that needs the greatest study and revision.

The foregoing are merely illustrative of points in the proposed amendments which we believe are inappropriate or require further consideration. If there are changes which should be made in this definition of "gross income from the property" and "ordinary treatment processes," we believe they can and should be more clearly and definitely stated without so much confusion and uncertainty as seem to exist in the proposed bill, without need to throw in question or brush aside long-established standards and precedents; with clearer and more definite statement of any changes which may seem desirable; and without discrimination against newer and improved processes or methods which should be employed if we are economically and adequately to provide the minerals we should have.

This analysis of the proposed legislation is necessarily incomplete and is not intended as a comprehensive statement of everything which should be changed or eliminated in the proposed legislation. It is assumed that in view of this and other testimony given at these hearings, there will be some restudy and revision of the proposed section 613.

I can assure you that the committeee on Federal taxation and other members of the Mining and Metallurgical Society will be glad to assist and to give the benefit of the very long and distinguished experience of some of our members if they can be of any help in clearing up this situation.

I thank you.

The CHAIRMAN. Are there any questions?

Mr. Mason will inquire.

Mr. MASON. I understand, sir, that you are a geologist.

Mr. PELOUBET. Yes.

Mr. MASON. And accountant.

Mr. PELOUBET. Yes.

Mr. MASON. I want to try and get clear in my mind the difference between a marketable mineral commercial product that we are dealing with, such as cement and brick and Solite and such things, and a marketable manufactured commercial product such as autos and farm machinery and safety razors and so forth.

Now, during the hearings we have had jokingly cement, which is a marketable mineral commercial product, compared with an auto that is a marketable manufactured commercial product, and I want to know how to distinguish between those two.

Mr. PELOUBET. Well, I think it is quite easy to indicate the bottom of the scale and the top. Now, on the bottom of the scale I would say we have something like zinc concentrates or uranium concentrates. The so-called yellow cake that comes out of the uranium mill is the first product that anything can be done with from the uranium ore.

Now there you have, you might say, the bottom of the scale.

Mr. MASON. The first product that you can actually use for some purpose, would you say?

Mr. PELOUBET. Yes. Of course, you could not possibly ship some product of concentrating or crushing in the middle of a process. It

is the end of a rather long and somewhat complicated process but essentially one process.

Mr. MASON. Would you say this manufactured product, such as farm machinery and safety razors, is an end product for immediate use while the marketable mineral commercial product is not an end product but has to be used in combining it with other things to manufacture it into something else?

Mr. PELOUBET. I think that is generally true. I would not be sure that it is always true.

I think that, as far as metals are concerned, it is, I would say, invariable. When we get into the rather more difficult field of construction material, we have another situation, but for metals I think there is no question.

Mr. MASON. That is all, Mr. Chairman.

The CHAIRMAN. Are there any further questions?

If not, we thank you, sir, for this discussion of your viewpoint. It has been most helpful.

That concludes the calendar for today and, without objection, the committee adjourns until 10 a.m., tomorrow.

(Whereupon, at 12:30 p.m., the committee adjourned until 10 a.m., Tuesday, March 10, 1959.)

MINERAL TREATMENT PROCESSES FOR PERCENTAGE DEPLETION PURPOSES

TUESDAY, MARCH 10, 1959

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met at 10 a.m., pursuant to recess, in the committee room, New House Office Building, Hon. Wilbur D. Mills (chairman) presiding.

The CHAIRMAN. The committee will please come to order.

Our first witness this morning is Mr. A. R. Waters, president, Carter-Waters Corp., Kansas City, Mo.

Mr. Waters, you are recognized, sir.

STATEMENT OF A. R. WATERS, PRESIDENT, CARTER-WATERS CORP., KANSAS CITY, MO., ACCOMPANIED BY JOHN T. SAPIENZA, ATTORNEY AT LAW, WASHINGTON, D.C.

Mr. WATERS. Mr. Chairman and gentlemen, my name is A. R. Waters. I am executive chairman of the Carter-Waters Corp., of Kansas City, Mo. I have with me our counsel, Mr. John T. Sapienza. I appear on behalf of the Expanded Shale, Clay, and Slate Institute and its member companies, which represent about 75 percent of the production of expanded shale, clay, and slate in the United States.

The industry consists of approximately 40 small plants operating in many parts of the country. Expanded shale, clay, and slate are commonly known as lightweight aggregates. These aggregates are sold to customers for use in the manufacture of lightweight concrete. In recent years the annual production has been approximately 3½ million tons of aggregate with a value of about $21 million. Our aggregate is a low-priced product selling at an average price of $6 per ton or less.

The full depletion at 5 percent would be 30 cents per ton, or about $1 million deduction total for the entire industry.

The CHAIRMAN. $1 million?

Mr. WATERS. About $1 million; yes, sir, at the rate of 30 cents per ton, 5 percent.

The products of this industry are developed from certain special types of shale, clay, and slate deposits, having particular expansible characteristics not common to most natural deposits of shale, clay, and slate. These special minerals expand to several times their original size when they are subjected to high temperatures.

To the best of our knowledge, there are no sales in the industry prior to the processes to be described below. After 16 years in this business I can state positively that we have never sold 1 ton of our

material until after it was processed. Our aggregate at the time of shipping is still a raw material and has no general use except as an ingredient in concrete.

The processes customarily applied by producers of lightweight aggregate are as follows: After the mineral is mined from the deposit, it is crushed and screened and then fed into small rotary kilns, where it is heated to a high temperature. With the application of heat, gases and noninert matter are released, causing the mineral to expand. The expanded mineral is then crushed, sized and loaded for shipment. No other mineral or admixture of any kind is added to the raw shale, clay, or slate during the processing.

These processes are the ones normally applied by the industry in order to obtain a commercially marketable mineral product. They do not result in a finished or manufactured product. The aggregate is mixed with portland cement and water by the consumer to make concrete. Thus our aggregate competes with other raw materials which are also used as concrete aggregates such as gravel, sand, crushed stone, vermiculite and perlite.

In its concern about the revenue effect of the commercially marketable product rule in other industries, the Treasury Department has recommended a completely new definition of mining for percentage depletion purposes. The definition would throw out the commercially marketable mineral product rule and substitute a list of specified processes which are considered as mining. The proposal would also specify for the first time a number of processes which may not be included as ordinary treatment processes, such as a treatment effecting a chemical change or a thermal action.

We urge the Ways and Means Committee to reject the Treasury Department's proposal. The Treasury Department's bill would greatly complicate the computation of percentage depletion in our industry. Instead of the simple direct method of computing depletion on the basis of actual sales, the Treasury Department's proposal would supply cutoff points wherever a producer applies processes which have not been specified as allowable.

In our industry there are no sales of the raw mineral when it is about to be placed in the kilns, and it will be necessary to make complicated allocations of costs and profits between mining and nonmining processes in order to arrive at a theoretical value at the prekiln stage. Our producers are, in most cases, small business concerns, and to make the intricate accounting adjustments needed in cutoff computations would impose a very severe burden on them.

In the case of other minerals, the Treasury Department's list specifically includes thermal processes similar to those employed in our industry. The burning of magnesite, the furnacing of quicksilver ores and the sintering of phosphate rock are allowed, but in the case of other minerals a treatment effecting a chemical change or a thermal action is disallowed. We cannot see how the heating processes in the case of magnesite, quicksilver, and phosphate rock are considered mining processes while other thermal processes, such as the burning of lightweight aggregate, are treated differently. This would be discrimination without any visible reason.

Finally, we want to emphasize several aspects of our industry and competitive situation in which our producers operate.

First, expanded shale, clay, and slate used for lightweight aggregate receive percentage depletion at 5 percent. This is the very bottom of the percentage depletion scale, which runs as high as 27½ percent. In setting our rate at only one-twentieth of the gross income from mining, Congress has already discounted very heavily for the relation between our mineral and our product.

Second, our industry has about 30 producers and annual sales of approximately $21 million. We are, by and large, small business concerns, and the total amount of revenue involved under the commercially marketable mineral product rule in our industry is relatively very small.

If this committee agrees with the Treasury Department that there are some mining industries receiving excessive tax benefit from percentage depletion, we would suggest you deal with these industries specifically. Any attempt to specify in the statute all the allowable processes for all the mining industry will surely cause hardship to many producers whose processes are not listed.

Third, we want to emphasize that our industry encounters competition from other mineral products which already receive higher percentage depletion allowances.

For example, vermiculite and gypsum are in competition with our expanded lightweight aggregates, and they receive depletion at a 15-percent rate. Perlite is competitive with our product and it receives depletion at a 10-percent rate. In the interest of fairness, our depletion allowance should be, if anything, increased; certainly not reduced.

The Treasury's proposal seeks to place a harmful impact on small business and to the venture capital so necessary to its survival. No one opposes the right of the Treasury Department to seek adjudication of the rules governing the operation of this small industry, but everyone opposes the Department's initiating proposals which impair the financial stability of the industry and the free flow of venture capital to this small business after such investments have been committed. This is a new and struggling industry and any restrictions imposed upon it in the face of intense competition would prohibit its proper growth and place in the economy.

At this point I would like to digress just for a moment to explain that our raw material, which may be shale, clay, or slate, is of a special type and not easily found. From my own experience I can tell you that I personally spent between 4 and 5 years to locate a deposit suitable for our plant in Missouri, and I have just finished spending between 5 and 6 years in order to locate a suitable deposit in Iowa, so that there is a great deal of expense and time required to locate the special type of material for this process.

Finally, for the reasons explained above, we urge the Ways and Means Committee not to throw out the commercially marketable mineral product rule, and we ask you to continue to treat the burning of lightweight aggregate as an allowable process.

I appreciate being heard this morning. Thank you.

The CHAIRMAN. Are there any questions of Mr. Waters?

Mr. MASON. Mr. Waters, you have made your case, so far as I am concerned, and if they throw out thermal action your industry is just simply left high and dry.

Mr. WATERS. That is correct, sir.

Mr. MASON. That is all.

The CHAIRMAN. Mr. Waters, we appreciate your coming to the committee and giving us the benefit of your thinking on this point. Thank you, sir.

Mr. WATERS. Thank you very much.

(The following letter was subsequently received by the committee:)

THE CARTER-WATERS CORP.,
Kansas City Mo., March 13, 1959.

Re percentage depletion—shale, clay, or slate for lightweight aggregate.

Hon. WILBUR D. MILLS,
Chairman, Committee on Ways and Means,
House Office Building, Washington, D.C.

DEAR SIR: It was my privilege to appear before the Committee on Ways and Means at your hearing at 10 o'clock last Tuesday morning, March 10, on the above subject. At this hearing I represented the Expanded Shale Clay and Slate Institute as well as my own company. I believe you have a copy of my statement, but I wish to follow it up with several brief, but very essential facts:

1. After a controversy with the Internal Revenue Service which has lasted about 7 years, the courts have decided that under the present law we are entitled to full depletion on our processes including crushing, exposure to high temperature in a kiln, and screening. These processes are the ones normally applied by the industry in order to obtain a commercially marketable mineral product.

2. Our raw material is shale, clay, or slate of a special type and has no market or value until it has been processed.

3. The one important process required to change it from worthless raw material to a marketable lightweight aggregate is the exposure to heat in a kiln.

4. Unless this burning process is allowable for percentage depletion, which was intended by Congress as a benefit to our industry, the law will have little or no value to us.

5. I, therefore, urge you as a member of the Ways and Means Committee to let the law stand as it now is so that we may realize the benefits of the full 5-percent depletion.

Thanking you for your favorable consideration.

Yours truly,

A. R. WATERS.

P.S.—Thank you for your courtesy in giving me a hearing.

The CHAIRMAN. Our next witness is Mr. Cecil R. Haden, president of the W. D. Haden Co.

Mr. Haden, I notice that you are accompanied by one of our esteemed colleagues from Texas.

Mr. Thompson, would you desire to introduce Mr. Haden to the committee?

STATEMENT OF REPRESENTATIVE CLARK W. THOMPSON OF TEXAS

Mr. THOMPSON. Thank you, Mr. Chairman.

It is a pleasure for me to present to the committee Mr. Cecil R. Haden, who for the past 35 years has been actively engaged in the production of shells for marketing. He is presently the president of W. D. Haden Co., the place he took over from his father, who was the founder of it and one of the pioneers in the production of oystershells. Mr. Haden speaks with complete authority on this subject and I commend him to you.

The CHAIRMAN. Thank you, Mr. Thompson.

You are recognized, Mr. Haden.

STATEMENT OF CECIL R. HADEN, PRESIDENT, W. D. HADEN CO., HOUSTON, TEX.

Mr. HADEN. Mr. Chairman and members of the committee, my name is Cecil R. Haden. I am president of the W. D. Haden Co., with offices in Galveston and Houston, Tex. Our principal business is the production of clamshells and and oystershells and our annual production will average better than 2 million cubic yards per year.

While I am not here today as a representative of the entire industry, I can assure you that the remarks we make here and the remarks we have put into the record in our brief are of vital interest to the entire shell industry.

You have before you a bill suggested by the Secretary of the Treasury to define with more certainty depletion allowances. We in the shell industry are suffering severely from the lack of certainty on two points in depletion allowances. We have filed a brief in writing seeking a clarification of the depletion allowances on clamshells and oystershells.

My reason for appearing briefly and in person is that ours is a unique industry with extraordinary processes and limited to only a few States. It is a business very hard for those not engaged in to understand and we feel that it has been misunderstood by agents of the Treasury Department. This misunderstanding has been a great hardship to shell producers.

The result has been that we have been placed at a disadvantage as an industry with competitors supplying the chemical, industrial, and process equivalent.

Also due to the misunderstanding, a large and growing tax liability is being unjustly claimed against us and unless the facts of depletion allowances are swiftly clarified we will be under an unbearable burden.

At this point I would like to state that our company alone today has a tax liability in excess of $440,000 due to differences of opinion existing between our accountants and those of the Treasury Department. We have raised two points:

First, that clamshells and oystershells are the chemical equivalents of and are interchangeable with limestone rock. Both are calcium carbonates and it is obviously unfair to give one a tax advantage over the other.

Second, that the Government is contending that our production process ends at sea, at the point of production, where there is no market for our product and where it is still in the condition which will not meet the specification of our purchasers.

These points are elaborated in our brief and I have no intention of burdening this committee with repetitious statements. I have felt that I should appear to answer any questions you may have about our unique industry, since its operation and processes have baffled Government representatives.

I feel I may speak as an expert, since the company I represent is the oldest still engaged in the production of shells, and, as Congress

man Thompson has pointed out, I personally have been in this industry for more than 35 years.

The W. D. Haden Co., when my late father was president, designed and built the first mechanical and later the first hydraulic dredge for the production of oystershells. I was in charge of the first operation, which invented the process of making lime from oystershells. I worked with manufacturers of chickenfeed and other agricultural products from shells. We were the first suppliers of shells for the manufacturer of soda ash and dry ice. We supplied the first paper mill to cook pulp and bleach it with the shell product. We supply shells to the company that uses a shell product to extract magnesium from sea water.

The total production of shells in Texas for the past 6 years was some 65 million cubic yards. Of this, 16 million cubic yards were used by municipalities, and the State and other governmental agencies for roadbuilding. And 49 million cubic yards were used in private business. Of the latter, about 25 million cubic yards were used as calcium carbonate in the cement, chemical, and agricultural products industries.

We ask that Congress remove clamshells and oystershells from section 613, subsection (b), paragraph (5) of the Internal Revenue Code, where they never belonged, and place them in the section with limestone rock, which is our chemical equivalent and also a competitor of and interchangeable with shells in the manufacture of cement, lime, soda ash, dry ice, calcium carbonate agricultural products and under the processing of oxide ore and aluminum oxide and process of paper as well as the extraction of magnesium from sea water.

Also, we ask that you clarify the point at which depletion may be taken on shells to allow us to get these shells ashore, where the only market for them exists, and in the streams of commerce at the point where they are receivable to buyers as raw material.

Only your committee and the Congress can give us the relief and justice for which we pray.

(Prepared statement of Mr. Haden follows:)

W. D. HADEN CO.,
Houston, Tex.

HON. WILBUR D. MILLS,
Chairman, Ways and Means Committee,
The Congress.

DEAR CONGRESSMAN MILLS: With respect to the corrective legislation on depletion allowance, suggested to your committee by the Secretary of the Treasury, we would like to call your attention to two points in the proposed bill, as follows:

(1) Clamshells and oystershells have been erroneously grouped with mollusk shells, etc., whereas they are the chemical equivalent and are interchangeable commercially with limestone rock, etc., with which they compete, and with which they should have the same depletion tax allowance.

(2) There is a necessity for a settled formula to determine the exact point at which depletion allowance may be taken on clamshells and oystershells. Because of the unusual nature of our industry, confusion has developed as to this point. The urgency of this solution is demonstrated by the fact that this taxpayer's tax liability, for the calendar years 1951 through 1957, has reached a sum of $443,941.85 due to the disallowance by the Commission of depletion deductions aggregating $864,311.27 for the several years involved. Attention is

also, directed to the fact that interest at the rate of 6 percent per annum is accruing thereon.

We are stating our position as fully as possible in writing, so as to conserve the time of your committee, and our oral appearance will be very brief.

Very truly yours,

THE W. D. HADEN CO.,
CARL R. HADEN.

POINT I

In the suggested bill submitted by Secretary Anderson, section 1(a)(2) referring to subsection (b) of section 613, paragraph 5, clamshells and oystershells are erroneously grouped with mollusk shells, etc., when they should be grouped with limestone rock, etc., and permitted the same depletion allowance for the following reasons:

I. Clamshells and oystershells are the chemical equivalents of limestone rock, etc. ($CaCO_3$, or calcium carbonate), and shells and limestone rock are substitutes for each other in the cement and chemical industries, in the extraction of magnesium from sea water, in cooking paper pulp and bleaching of paper, in the manufacture of chickenfeed and other agricultural products. Shells and limestone rock are interchangeable in such manufacturing processes, are competitive, and neither should enjoy a tax advantage over the other.

1. Limestone and shells, geologically: While formed of the same chemical elements and often in the same manner, the principal geological difference between shells and limestone, chalk, and similar minerals is a matter of age.

In the area where shells occur in commercial quantities, limestone and chalk were laid down principally in the Cretaceous Age, between 70 million and 120 million years ago. The principal shell reefs probably are no older than 50,000 years.

2. Limestone and shells, chemically: Exactly the same except for impurities in each—calcium carbonate ($CaCO_3$). Usually clean shells are more completely calcium carbonate, from 97 to 99 percent, and limestone rarely attains this degree of purity.

3. Limestone and shells, physically: A matter of consolidation. Limestone is an aggregate, often occurring in solid blocks. Shells are in individual shells, rarely cemented or packed together to any noticeable degree.

4. Limestone and shells, industrially: In the manufacture of cement, lime, etc., limestone and oystershells are interchangeable, with a slight modification of equipment. Usually, shells are slightly harder to grind than many limestones, and methods of handling vary somewhat, as limestone comes in heavy chunks, while shells are light, individual shells.

5. Limestone and shells, quantitatively: It is beyond question that there are many thousand times more of tons of limestone than shells commercially available, and that shells are being depleted more rapidly, on a percentage basis.

6. Compared to production of limestone, shells require more and more expensive equipment, operations, and crews.

(*a*) *Occurrence.*—Limestone rock occurs on dry land, within easy reach of most manufacturing and process areas. Clamshells and oystershells occur in commercial quantities only beneath the waters of salt bays, inlets, lakes, and in swamps.

(*b*) *Production.*—Blasting powder, a dragline, rock crusher, and dump trucks are the principal requirements of producing limestone rock . A hydraulic dredge of a cost sometimes exceeding $1 million, a fleet of barges and towboats, work boats, a marine yard for repairs, landing docks, unloading cranes and large storage areas to permit the drying of shells are necessary before shell production can start.

(*c*) *Hazards.*—Limestone rock is produced in the safety of land. The equipment of shell producers is at all times exposed to the hazards of the sea. Barges frequently overturn and sink, and must be salvaged at great expense. Storms are a constant peril, especially to costly dredges, which are not self-propelled and cannot easily flee to the safety of the shore. Even in normal weather the action of the waves bangs thinskinned vessels together, denting, damaging, and not infrequently puncturing them. A slight miscalculation in docking a barge, laden perhaps with 2,000 tons of shells, may knock down the dock or wreck the

barge. Rust is constantly at work, eating up the equipment. An operator in the shell-production field is occupied at all times in the repair business.

(*d*) *Procurement of staff.*—The limestone miner spends his nights at home, safe and secure. It is not easy to tempt a worker to join the crew of a dredge, operating miles from shore, who normally must be away from home 10 days at a time, with his family worrying about every storm cloud. Of necessity, the shell crews must be fed while at work at company expense, and free food stimulates a heartier appetite. A crew boat must operate daily, bringing food and supplies to the site of operation, and changes of personnel. All of which means the shell producer must bid high to obtain satisfactory employees, and pay high to keep them.

(*e*) *Skill of staff.*—It is axiomatic in such businesses as limestone production that anybody can drive a truck or swing a shovel. Only skilled seamen can pilot towboats over the vast water areas of shell production. Even a deckhand on towboat or dredge in addition to normal duties must keep his feet on a deck flowing with water or go overboard. The operation must continue around the clock, in dark or light, in roasting summer or the freezing gales of winter. The shell producer is a seaman, and in addition to normal skills of the trade, must know the fickle sea and be able to cope with its perils.

(*f*) *Exploration.*—Limestone usually outcrops, visible to all, and a few test holes may prove up a supply of years. Shells are not only hidden under water, but usually buried under mud on the bay floor. They occur in reefs, some small, some larger, but often separated by vast unproductive areas. To locate shells requires special probing equipment, experts in probing, establishment of surveying monuments on the shore, surveying crews to mark the site of finds and mapping crews to locate them on maps. This work must go on with the survey boat at sea, bouncing around in the waves, often interrupted by fogs, rains, storms, and other inclement weather.

POINT II

An explicit statement is needed as the point where depletion allowance may be taken on clam shells and oyster shells.

Mining of shells is unlike mining of minerals where the mine shaft is fixed in one place. In the case of shells, the "mine shaft" is the dredge, which is portable, and must be moved wherever the shells may be found. This distance often is many miles, and as shells are depleted may become as much as 200 miles.

Presently, there is such confusion that, if five conscientious Treasury agents computed the depletion allowance of a single shell producer independently, they probably would reach five different answers.

To anyone familiar with shell production, it is obvious that the process of delivering commercial shell may not be completed at the dredge, which is at all times offshore where shells may not be stockpiled and adequately drained.[1] Proper drainage of shells is a necessity, as the specifications of purchasers call for a lower moisture content than that attainable at sea; they want calcium carbonate, not H_2O, or water.

We believe that it should be made clear that depletion allowance on clam shells and oyster shells should be computed at the point where the shells enter the streams of commerce, acceptable to the purchasers as a raw material.

The CHAIRMAN. Are there any questions of Mr. Haden?

If not, Mr. Haden, we thank you, sir, for bringing to us this information on this point, and we appreciate, Mr. Thompson your coming to the committee.

Mr. THOMPSON. Thank you, Mr. Chairman.

I ask permission to file a statement at a later time.

The CHAIRMAN. Without objection, that statement will appear at this point in the record.

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[1] At least 65 percent of each pound of material dredged is water, and content averages between 16 to 22 percent moisture, even after transferring to barges. A minimum of 24 hours of drainage, on shore, is needed to reduce this moisture content below the 9-percent maximum acceptable by State, city, and county government purchasers.

STATEMENT BY REPRESENTATIVE CLARK W. THOMPSON, OF TEXAS

The witness you have just heard, Mr. Cecil R. Haden, speaks with complete authority on the subject of what we call mud shell. As he has pointed out, he has spent his life in the business of dredging and marketing that product. What he has told you today is a story typical of the entire industry on the gulf coast.

I commend his statement to you and urge that it be studied with great care. If you see fit to follow his recommendations, you will be doing a service to the entire industry.

Mr. IKARD. Mr. Chairman, I would also like to mention the fact that our colleague, Mr. Casey, from Houston, is also present.

The CHAIRMAN. I appreciate your calling that to my attention.

Mr. THOMPSON. I share Mr. Haden with the gentleman from Texas, Mr. Chairman. He operates in the district of both of us.

The CHAIRMAN. I had not observed that Mr. Casey was in the room. I think it was partially because he was sitting behind Mr. Ikard.

Mr. THOMPSON. I was going to ask permission for Mr. Casey to place a statement in the record, but he is here and I will not presume to ask it for him.

The CHAIRMAN. Mr. Casey may have that permission also.

STATEMENT BY REPRESENTATIVE BOB CASEY, OF TEXAS

Mr. CASEY. I respectfully request the committee to give due weight to the expert testimony of the witness you have just heard, Mr. Cecil R. Haden. His oral statement is augmented with a concise written presentation detailing the problems the entire shell industry has been facing for the past 10 years. If the committee sees fit to follow the recommendations of Mr. Haden it will be performing a service to an important segment of our economy, and will in fact place two industries on a more equal competitive basis.

The CHAIRMAN. Thank you.

Mr. THOMPSON. Thank you, Mr. Chairman.

The CHAIRMAN. Our next witness is Mr. R. B. Carothers, the president of H. C. Spinks Clay Co., of Paris, Tenn.

Mr. Carothers, we quite well recall your previous appearances before this committee and we welcome you back today.

STATEMENT OF R. B. CAROTHERS, PRESIDENT, H. C. SPINKS CLAY CO., PARIS, TENN.; ACCOMPANIED BY REPRESENTATIVE ROBERT A. EVERETT, OF TENNESSEE, AND REPRESENTATIVE FRANK A. STUBBLEFIELD, OF KENTUCKY

Mr. CAROTHERS. Thank you, sir.

The CHAIRMAN. You are recognized, sir.

Mr. CAROTHERS. Mr. Chairman and gentlemen, my name is R. B. Carothers, president of the Spinks Clay Co., of Paris, Tenn. My company is engaged in the production of ball clay, and as I appear before you today I represent also my eight neighbors and competitors who have asked me to speak for them in their behalf.

These companies that are involved are the Cooley Clay Co., the Old Hickory Clay Co., Kentucky-Tennessee Clay Co., and the Kentucky Clay Mining Co., all of whom make their headquarters in Graves County, Ky. That is in the First Congressional District of the State of Kentucky.

We have also the United Clay Mines Corp., the Bell Clay Co., my own company, and the Tennessee Clay Absorbent Co., and the Southern Clay Co., whose properties are located in the Seventh and Eighth Congressional Districts of the State of Tennessee.

Two of the Kentucky companies that I mentioned also operate in Tennessee. One of the Kentucky companies operates in the Second Congressional District in the State of Mississippi. I mention the location of our properties in relation to our representation here in Congress, as we feel that we are very ably represented by Mr. Murray, and Mr. Everett, and Mr. Stubblefield and Mr. Whitten, and I believe that if there is any question that you want to ask these gentlemen about the business that we operate there, they can tell you about our businesses because they are thoroughly familiar with our local industry down there.

The CHAIRMAN. Mr. Carothers, I notice that Mr. Everett and Mr. Stubblefield are present in the room. Would you gentlemen desire to come to the witness table with Mr. Carothers? You may do so if you care to and if you have any statement that you would like to put in the record at the conclusion of Mr. Carothers' statement, you may do so without objection.

Mr. EVERETT. Thank you.

Mr. CAROTHERS. I would like to merely talk to you about our problem as we see it and what depletion means to us, rather than read a prepared statement to you, as I believe I can better explain it to you in this way, and if I confuse you, as I am sure I will before I am done, I will appreciate it if you will ask me to explain what I have said so that I can make it clear to you.

We feel that the percentage depletion allowance—it is called an allowance—is a very just and fair way to determine the amount of money that is allowable to our producers to enable us to replace the physical property, the physical asset, that we have shipped when we sell a ton of clay, and to allow us sufficient income or nearly so to replace that property and put it back in our physical account or capital account, and for that reason, certainly the law as it is written now and as it is operating must be all right.

In 1941 we came to this committee and to the committee in the Senate and asked you gentlemen to make the percentage depletion method of figuring our taxes applicable to our industry, and you did so. It was first applicable for the taxable year beginning on January 1, 1942. This method of figuring our taxes can't be right unless it has produced additional revenue for the Government and additional industry and economy for our local communities, so that I want to bring out to you about two figures.

In 1940 our industry did in the whole United States produce a little over a million dollars worth of ball clay. In 1941 the figure was $1,600,000. In 1942, for some reason it dropped back to $1,300,000. In 1956 the industry produced a total dollar sale of a little more than $6 million. In 1957 it dropped back a little bit. In 1958 the figures when they are compiled by the Bureau of Mines will be a little bit more, we believe, than $6 million.

We cannot give you the exact figures in advance that will be the Bureau of Mine figures because there is a small amount of ball clay produced outside of our area, but the area that we operate in and the companies that we represent produce approximately 90 percent, never

less than 89 percent, and in some years 96 percent, of the total ball clay production in the United States.

So if under this method of figuring our taxes these companies have been able to expand their business, they have expanded their payroll. If they have expanded their payroll, certainly the Government got more taxes because we take that out when we make up the payroll. These companies have all paid their taxes cheerfully. We have no company in the industry, to the best of my knowledge, and I am sure I am right, that is in any argument with the Department of Revenue today, so I am not here to ask you to legislate us out of a lawsuit, and I surely hope you don't legislate us into the courthouse. That is what we are afraid of.

We are really afraid of that and I will tell you why; because we don't have a lot of lawyer money available. If you gentlemen do feel that it is necessary and adivsable for you to make some changes in this law, we believe that the changes can be made without tearing apart the law as we have it now, because we know we are operating satisfactorily to all concerned under the present regulation. At least it appears that we are, because there is no contention about our taxes.

We think that with a little "country boy" language, we could differentiate between the processes that our customers use in manufacturing articles out of the clay that we sell to them and the processes or the necessary steps that we must take to separate our clay from the impurities and the water and get it into the car or the truck and ship it to these customers.

If you do desire to make a change, I know that it is not up to us to tell you what to do. If that is necessary and you want to do it, we hope that you will approach the problem in that way.

The reason that we want you to do that is this: that if you put an end-use definition on our materials you get into a lot of trouble and you will certainly get into a lot of confusion. Ball clays are sold on the basis of their chemical and physical analyses, and with your permission, Mr. Chairman, I would like to send to you gentlemen a typical data book or information pamphlet on one or two of our companies, so that you can see just really what we say ball clay is, and I would like to make one of those a part of the record.

The CHAIRMAN. How voluminous would it be, Mr. Carothers?

Mr. CAROTHERS. To tell you what the chemical analysis is, what the physical properties are, and give you an idea of the variation.

Mr. MASON. Are there 6 pages in the pamphlet or 10?

Mr. CAROTHERS. That is right.

The CHAIRMAN. Without objection, that will be made a part of the record.

(Information referred to follows:)

[Excerpt from "Spinks Data Book"]

SPINKS LABORATORY PROCEDURES FOR TESTING

CHEMICAL ANALYSIS

Silicon dioxide (SiO_2)

Weigh a 0.5 gram sample of dry clay and mix thoroughly with 3.5 grams of sodium carbonate. Cover platinum crucible and fuse to a glassy mass. Cool and add 30 milliliters of HCl (1–1) keeping covered to avoid loss by splattering, and digest until there is no further reaction. Break up residue with a glass rod. Evaporate to dryness on a steam bath. Heat in constant temperature oven at 110° C. until no odor of HCl is perceptible. Cool and add 5 milliliters

of HCl, digest 2 minutes, and wash sides of dish with hot water. Let digest 5 minutes on steam bath. Filter through Whatman #40–11 centimeter filter paper and catch filtrate in 400 milliliter beaker. Scrub dish thoroughly with rubber policeman and wash filter paper and residue 5 to 10 times with hot water. Repeat evaporation as before, reserving filtrate for R_2O_3 determination.

Place the two filter papers with their residue in a tared platinum crucible, and carefully char paper by directing flame against the top of the crucible. Transfer the flame to the base of the crucible and drive off the carbon by gradually increasing the heat so as not to allow paper to flame. When precipitate becomes white, close crucible and heat at 1,000° C. for 20 minutes. Cool in dessicator and weigh as impure SiO_2. Add to crucible 12 drops of sulfuric acid and 15–20 milliliters of HF. Evaporate to dryness on steam bath, heat to 1,000° C., cool and weigh. Loss of weight is SiO_2. Multiply by 200 for percent. Nonvolatile residue weight is added to R_2O_3.

Iron and aluminum oxide (R_2O_3)

Add to filtrate reserve from silica filtration 1 macerated 11 centimeter filter paper (ashless), and 3 drops of 0.1 percent methyl red solution. Bring to boil, remove from heat and with constant stirring add, dropwise, dilute ammonium hydroxide (1–1) to change of indicator color and 1 drop in excess. Bring to boil for 1 minute. Filter hot through Whatman #40–11 centimeter filter paper catching filtrate in 400 milliliter beaker. Use hot 2 percent ammonium chloride to scrub beaker and wash precipitate 5–10 times. Transfer residue to tared platinum crucible and ignite to 1,100° C. for 30 minutes. Cool in dessicator and weigh as R_2O_3. Multiply by 200 percent. Add nonvolatile residue of silica to R_2O_3.

Loss on ignition

Weigh into a platinum crucible a 1,000 gram sample of dry clay. Ignite at 1,000° C. for 1 hour. Cool in dessicator and weigh. Loss in weight multiplied by 100 gives percent loss on ignition.

PHYSICAL PROPERTIES

Percent moisture (wet basis)

Weigh out 500 grams of clay sample and dry to constant weight at 110° C. and reweigh. Difference in weight divided by 500 multiplied by 100 gives percent moisture of clay.

Percent residue

Weigh out 4,500 grams wet clay and place in blunger with sufficient water to produce fluid slip, and blunge until clay is thoroughly slaked down. Add flint equal in amount to dry weight of clay sample and continue to blunge until well mixed. Screen through 60 mesh sieve into plaster bats or filter press to remove water. Dry screen and residue, and weigh. Weigh empty screen. Weight of residue divided by dry weight of sample times 100 is percent residue.

Viscosity

Adjust small portion of screened slip to a specific gravity of 1.20 using a 500-millimeter volumetric flask and balance. Check viscosity of this slip on a Stormer viscosimeter. Check viscosity of distilled water on the same viscosimeter. Viscosity of clay slip divided by viscosity of H_2O is the relative viscosity.

Rate of cast

Cast remainder of this adjusted slip in plaster mold for 15 minutes, drain and allow to dry and release from mold. Weigh bone-dry cast piece. Record weight as cast per 426 square centimeters for 15 minutes.

Percent water of plasticity

After main sample has dried to a plastic mass, extrude 10 bars for dry modulus of rupture, 10 bars each for each firing temperature and 4 bars for water of plasticity. Mark all bars for shrinkage. Weigh four of the bars and dry completely, and reweigh. Difference in weight divided by dry weight times 100 is percent water of plasticity.

Percent linear shrinkage

Dry marked bars at room temperature for 24 hours, and then at 110° C. until bone dry. Measure marked length with calipers. Save 10 dry bars for modulus

of rupture. Fire others to cone 04, 8, and 11, respectively. Measure all with calipers. One hundred minus dry length is percent dry shrinkage. One hundred minus fired length is the percent total linear shrinkage. Total shrinkage minus dry shrinkage is percent fired linear shrinkage.

Modulus of rupture

Break dry bars on a Dillon tester, using a 2-inch span. Record reading on dial. Repeat this procedure with fired bars using a 5-inch span. Eight times the dial reading in pounds times span of knife edges in inches divided by π times the diameter of the bar at break in inches cubed gives the modulus of rupture in pounds per square inch.

Weight loss in firing

Fire the bars used to obtain water of plasticity to the various temperatures and weigh after each firing. Difference in fired weight and dry weight divided by dry weight times 100 gives percent loss of weight in firing.

Percent absorption

Weigh fired bars, boil for 4 hours, and allow to soak overnight in the same water. Wipe off excess water and weigh. Saturated weight minus fired weight divided by fired weight times 100 gives percent absorption.

Tile pressing equipment

The sample of 100 percent clay at 1½ to 2 percent moisture is placed in a small Simpson mixer for 20 minutes; then passed through a 20 mesh screen. A sample of 27 grams is placed in a 2- by 2-inch die and pressed at 6,000 pounds per square inch on an F. A. Nugier Co. hydraulic jack press. The tile is removed from the die with an air cylinder and fired to cone 2, 4, and 8. From these tile, absorption and shrinkage were determined.

Particle size

A 5-gram sample is mixed with 250 cubic centimeters water and 3.4 cubic centimeters of Daxad on a Waring blender for 10 minutes. The sample is then blunged for 12 hours at 25 revolutions per minute. At the end of 12 hours, the sample is placed on a shelf; hydrometer and temperature readings are recorded. After 1 hour, the sample is placed in an International centrifuge and run on a precalculated schedule taking hydrometer and temperature readings at each interval. The particle diameter is determined by the use of a Nomograph chart, using the true specific gravity, hydrometer reading, and temperature. The true specific gravity is determined with a Le Chatelier bottle and kerosene.

Thermal expansion apparatus

Sample bars 7 inches by ⅜-inch diameter of 100 percent clay are previously fired to cone 8 and placed in an industrial engineering thermal expansion furnace and heated to 700° C. at a rate of 150° C. per hour. The sample bar is placed between two quartz rods, one contained within the other, with a dial micrometer indicating the expansion to the nearest 0.0001 inch.

Gradient firing apparatus

Sample bars 1 inch by ½ inch by 7½ inches of 100-percent clay are placed in an R. L. Stone & Co. gradient firing furnace. The furnace is fired to 2,300° F. in 7 hours with 10-minute soak periods at 600°, 1,000°, 1,200°, 1,400°, 1,700°, 2,000°, and 2,300°. The floor of the furnace contains thermocouples at 0 inch, 1½ inches, 3 inches, 4½ inches, 5½ inches, and 6½ inches from the center of the hot zone. Giving a single bar showing the fired condition of from 0° to 2,300° F. We have found the end point of 2,300° F. to be approximately cone 13.

DEFLOCCULATION CURVES

1. Mix a total of 500 grams of clay and water varying each with different clays so that the apparent viscosity is constant for all of the clays before electrolyte is added, making them all as thick as possible and recording the specific gravity of each clay slip.
2. Use a standardized electrolyte of N brand sodium silicate, made up in a series covering the range of 0.0 to 0.5 percent. This range may be changed depending upon the clay.
3. Add the electrolyte in increments of 0.05 percent up to the point where deflocculation occurs, and in this region decrease the size of the increments to obtain better definition in the zone of deflocculation.

4. Mix the sample in a Hamilton Beach mixer for 20 minutes and allow to set for 4 hours before test is made.
5. Test samples with the varying amounts of electrolyte on a Stormer viscosimeter for apparent viscosity as a function of time.
6. Plot curve with percent electrolyte on abscissa versus viscosity, recorded as seconds per 100 revolutions of the Stormer, on the ordinate.

SOLUBLE SULFATE

Weigh out enough clay to be equivalent to 1,200 grams dry weight by calculation from the moisture content. Place in a clean ball mill. Add distilled water, by weight, to make a total of 4,200 grams of clay and water. Ball mill for 4 hours. Filter press, obtaining a clear 150-milliliter sample of the filtrate about 1 minute after the filtrate starts coming through.

Pipette 25 milliliters of sample into a 300-milliliter Erlenmeyer flask. Adjust, if necessary, to a pH between 4.5 and 8.0 with either 0.01 N HCl or 0.01 Na_2CO_3. Add 1 dipper of THQ indicator and shake until dissolved. Add 25 milliliters of iso-propyl alcohol and shake thoroughly. Titrate with M/80 barium chloride to the end point using a daylight bulb to illuminate the sample. The milliliter barium chloride multiplied by 2.5 is equal to the equivalent-parts-per-million of sulfate.

Mr. CAROTHERS. I think it is something you could look at very quickly and get some very pertinent ideas about our problem.

The CHAIRMAN. We will be pleased to have it, Mr. Carothers.

Mr. CAROTHERS. Thank you, sir.

The changes in our industry that have gone on during these years when we have figured our taxes on the depletion basis we feel are just small changes to the changes that will be necessary for us to stay in business for the next 15 years.

The two things that are affecting the sale of ball clay quite definitely are imports and transportation charges.

As transportation charges increase, the competition that we get from the imported ball clay, the imported raw material, increases. You can buy in the Great Lakes today a ton of English ball clay cheaper, for less dollars per ton, than you can buy a ton of Tennessee, or Kentucky, or Mississippi clay, and when the channel is opened up and shipping into the lakes increases, I imagine they will have a better chance at us dollarwise.

At many places on the eastern coast and on the west coast the imported clays are cheaper than our clays, so to get that business we have to do a better job of separating from our clay the impurities and the unnecessary moisture.

Our clays are shipped generally in three stages of beneficiation and for that reason we feel quite certain that the suggested language of the Treasury will get us in trouble.

In 1951, for instance, 61 percent of our tonnage was in shed-dried crushed or ground form, 11 percent mechanically dried and crushed and ground, and 20 percent fine ground clay. Air floated, we call it, which would come under the heading, I am quite sure, of final pulverization.

The competitive effects of transportation costs and the competition that our customers are receiving from imported ware have put us now in the position where last year 42 percent of my own company's tonnage—I don't have the figures for the whole industry, but I know it is typical of the figure—was, of this first stage of beneficiated clay, 24 percent was mechanically dried, and 34 percent was air floated and dried and separated from the impurities that occur in our clay in the natural state.

Therefore, you can see that in order to stay in business, we have to do a better job. We know the processes of making things. We know what the methods of beneficiating materials in our industry are today, so we can name manufacturing processes that we can outlaw today and we can name beneficiating mining processes that we can allow today, but we don't know the names of those operations that are going to exist in a couple of years from now.

We get ourselves in the position where if one of our companies would develop some new means of beneficiating our clay, then we would have to be back here bothering you gentlemen again, and I think you are bothered enough as it is, as I have observed the hearings here for the last several years.

Those are some of our reasons why we feel we are going to get in trouble with those things.

The reason that we get into fine pulverization when we grind our clay in a hammer mill is this: That the clay itself is a very fine particle material. That is one of the things that makes it ball clay as distinguished from other clays.

A micron is one one-thousandth of an inch and in describing the grain size, the natural grain size, not ground to this size, but the natural grain size, of our material, we talk about it in microns of one one-thousandth of an inch.

One typical clay that my company sells we call our champion and challenger clay. As it comes out of the ground and we make a micron test on that clay, 74 percent of it is finer than 2 microns and 44 percent of it is finer than one-half a micron. Therefore, when we put this material in a hammer mill and grind it, there is no such thing as fine grind or fine pulverization. If you grind it at all, it is pulverized, because it was a very fine material when the Lord created it.

We do not crack the crystals or the natural particles of clay. We just divide them one from the other.

The reason that we have to pulverize in order to properly grind our clay is that if you take a piece of clay as big as that pitcher and apply enough hot air or heat, heat in any form, to dry that lump of clay down to a percentage at which you can afford to ship it, you would be inclined to bake the outside and leave the inside still damp.

However, if you run that clay first through a mill and hammer it and get it down to small particles, then you can dry it without changing its plastic qualities or without the danger of calcining the clay.

Then, too, one of the methods today of beneficiating our clay is to pulverize and dry the clay and then separate the impurities out of the clay by air flotation. We get it in a dust in a current of air and the particles of impurities are heavier than the particles of pure clay, so when it gets in a swirl they go to the outside and we bleed them off out of the air system. We don't beneficiate our clay economically or properly without fine pulverization and, as the Treasury has suggested here, that is outlawed.

Another thing that we worry about here is the reference by the Treasury in their suggested language of designating clays as clays sold on the basis of their refractory properties.

When you get into end uses, you must of necessity base your decision on the basis of whom you sell these clays to and what they use them for.

One of our big tonnages in our industry for years was dinnerware. Now, the dinnerware industry, as you have been told here, I believe, in this committee room, has just been nearly ruined by foreign competition, so we have had to get more industries and other people to buy our clay. Our biggest tonnage today for the companies that I represent is the sanitary ware industry and the wall tile industry. That is interior tile; that is not the supporting tile.

Other industries that use our material, of course, are refractories, and electrical powerlines is a big user of our clay in the ceramic field. But we do get out of the ceramic field, and we call those outside customers. We speak of them as fringe benefits to our industry.

One of the industries that we get into and one of the uses we developed for our clays which was very helpful to us, too, in keeping up enough tonnage to make us operate at a profit is the insecticide industry, and also, strange as it may seem, the feed industry.

Some of our clays have been used in very small percentages and they are used every day as additives to feeds that are pelletized. They make the material come through the pelleting machine to better advantage and they make the pellets stay together and the clay doesn't hurt the animal. It helps him. We know it doesn't hurt him. Asphalt emulsifiers for very special uses have been using our clay. You take our clays and blend them with other clays and make water-retention materials. We call them pond stoppers.

We make some combinations out of our clays that we call welder clays for rotary drilling of water wells; and the pencil industry uses approximately a thousand tons a year of our clay. The ball clay business in Mississippi has not been developed to the extent that it has in Tennessee and Kentucky, but they are today producing some 14,000 tons a year down there.

I do not want to wear you out. I don't want to take any more time than is necessary. I believe that a good many of you are familiar with our industry and I hope that I have put my problem before you.

We are not manufacturing a product. We are not in the manufacturing business. We could get in some manufacturing businesses, I imagine.

My own company does process adhesives and we put our clays in those adhesives, but we keep that business separate from the clay operation and we keep separate costs on it and we charge the adhesive business for the clay and take the depletion on the clay and not on the adhesive. There has never been any question about it. It has never been any cause of contention. I do hope you will keep us in business and keep us in a condition so that we can operate without contention.

The CHAIRMAN. Mr. Carothers, during your statement I observed that your Congressman, our very good friend from Tennessee, Mr. Murray, arrived in the room.

I also observed that the distinguished gentleman from Kentucky, Mr. Spence, came in.

Perhaps these gentlemen would like permission also to insert some statement in the record at the conclusion of your statement.

Without objection, they may have that permission.

Mr. CAROTHERS. I will certainly not object to anything my group of Congressmen say. I am right proud of this group of gentlemen.

The CHAIRMAN. That will make it unanimous then, because none of us will object.

Mr. Carothers, we do appreciate your very fine statement regarding this subject. I have always looked upon you as being quite an authority in the field of production of ball clay. I have had occasion in the past on numerous times to discuss this matter with you. I know of your great experience in this field, and I am sure that the committee will recognize this experience and give great consideration to what you say.

Are there any questions?

Mr. CAROTHERS. Thank you.

The CHAIRMAN. Mr. Mason.

Mr. MASON. Mr. Carothers, you are not only an expert in the clay field, but you are a philosopher.

Mr. CAROTHERS. Thank you.

Mr. MASON. You summarized your whole point, or epitomized it, maybe I better say, in the statement that you are not here to ask us to legislate you out of a lawsuit, and you hope we will not legislate you into a lawsuit, and that in my opinion epitomizes the whole problem that your industry has, and that is the one thing this committee ought to be mighty careful about, changing the depletion base so as to legislate a lot of people into lawsuits that are not in them now.

That is all, Mr. Chairman.

Mr. FRAZIER. Mr. Chairman.

The CHAIRMAN. Mr. Frazier will inquire.

Mr. FRAZIER. I want to take this occasion to compliment Mr. Carothers on his fine statement and to ask one or two additional questions.

Mr. Carothers, as I understand you to say, this clay was sold upon the basis of chemical and physical analysis.

Mr. CAROTHERS. That is right.

Mr. FRAZIER. Ball clay is not just the ordinary clay that most of us are familiar with that you can get in most every State?

Mr. CAROTHERS. There are thousands of tons of clay in the areas in which we operate that won't qualify as a salable ball clay by reason of the fact that it is loaded down with impurities and doesn't have the proper plastic qualities or the proper grain size, and so forth, and our customers, after all, are the bosses, and we can't produce a clay and sell it or produce revenue for taxes or anything else if we don't get along with our customers, who demand that we furnish them with the definite information as to the physical and chemical analysis of the material that we are shipping.

Mr. FRAZIER. In view of that statement, do you use the depletion allowance for prospecting for this ball clay?

Mr. CAROTHERS. We use it as far as it will go.

Mr. FRAZIER. However, you have to go a good deal further, I judge, from that.

Mr. CAROTHERS. Yes, sir. There are many years when we spend more than our depletion allowance figure in prospecting for ball clays. Then of course you can spend your money to go find this clay, and then you have to buy it from the man who owns the land, and that takes another dollar or two. When you own the land, after you have

purchased the land or acquired it under lease contract and paid a figure to get the lease established, then when you ship a ton of clay out of that property, it is gone. You cannot replace it. It is really depleted. It is absolutely out of your hands.

We can on our own lands mine our clays, put our land back in a reasonable condition, and rebuild into that land its agricultural fertility, but we cannot by any process that is known to anybody rebuild back into that land that ball clay.

Mr. FRAZIER. How do you mine this clay, or how is it taken out?

Mr. CAROTHERS. We mine it by strip mining. We mine it with draglines, shovels, and bulldozers, and remove the overburden and then remove the clay. We generally put the overburden back in the old hole behind us.

Mr. FRAZIER. I believe you said you took the moisture and other impurities out of the clay. Is that a pretty expensive process?

Mr. CAROTHERS. We remove our moisture by merely piling our clay in sheds and letting it air dry, and that will reduce the moisture some 6 percent maybe, or 8 percent, and then the next step is to grind and crush the clay and run it through a rotary dryer and apply heat.

There again we run into this word "thermal" in the suggested language here as presented by Mr. Lindsay. If we can't use heat, we can't dry it; because there is no way you can dry a material without heating the material and heating the air that is to carry the water away. Drying is a relatively simple process. If you have a given cubic foot of air and it is at a reasonable condition of humidity, having, say, maybe 10 percent of water in that air, if you heat that air it expands and you can expand that air to another 10 percent of its size and then it has room to carry another 10 percent of water away with it when you move it on past your materials. You have to have heat. You have to use heat. We burn a thousand gallons of fuel oil a day in one of our plants.

Mr. FRAZIER. I judge from what you said that this ball clay was originally used for making china?

Mr. CAROTHERS. It still is, too; but that business has decreased very drastically due to importation.

Mr. FRAZIER. Clay being brought in from Englnad and other places?

Mr. CAROTHERS. Finished ware from Japan, England, and Czechoslovakia, and low-labor-cost countries.

Mr. FRAZIER. I believe that is all. Thank you very much.

Mr. CAROTHERS. Thank you, sir.

The CHAIRMAN. Are there any further questions of Mr. Carothers?

If not, Mr. Carothers, again we thank you, and we thank you gentlemen for accompanying Mr. Carothers to the witness table. We appreciate the presence of all four Members of Congress.

Our next witness is Mr. Spencer W. Pitts.

Mr. Pitts, please come forward, sir, and for purposes of this record please identify yourself.

STATEMENT OF SPENCER W. PITTS, SECRETARY, J. M. HUBER CORP., RED BANK, N.J.

Mr. PITTS. Mr. Chairman and gentlemen of the committee, my name is Spencer W. Pitts. I am assistant to the president and secretary of J. M. Huber Corp., Red Bank, N.J., and am appearing for that company.

J. M. Huber Corp., among other things, mines china—kaolin—clay in South Carolina and Georgia and sells this clay principally to the paper, rubber, adhesives, ceramic, and insecticide industries.

I might say that we are also producers of oil and gas, principally in Texas, and understand very well the operation and the importance of percentage depletion.

The purpose of this statement is to urge the revision of amendatory legislation proposed by the Treasury Department which relates to the present law on percentage depletion in the mining of china—kaolin—clay.

I might interject here and say that after having heard Mr. Carothers, and Mr. Mason's comment on Mr. Carothers' statement, I want to indicate that we, too, fear that we might be legislated into litigation and want to avoid that, and that is the principal purpose of the comments I have to make.

We recognize as sound the position advanced by the Treasury Department that it is unreasonable and beyond the intent of the law to permit percentage depletion on the inflated scale which recent court cases involving manufacturers of brick and cement have authorized. Amendatory legislation is, therefore, quite proper in our opinion.

Our sole concern is that, in amending the law to remove imperfections regarding brick and cement, unintended harm is not done to the china clay industry. We, therefore, recommend the following specific changes in the proposals made by the Treasury Department:

Item 1: The new bill proposed by the Treasury Department would amend subsection (b) of section 613 relating to percentage depletion rates and would allow 5 percent depletion gross income from:

> * * * clay used, or sold for use, in the manufacture of building or paving brick, drainage and roofing tile, sewer pipe, flower pots, and kindred products.

The term "kindred products" is objectionable for the reason that it too vague and might very readily result in allowing the china clay industry only 5 percent on certain types of clay which it sells in considerable volume for whitewares, interior floor, wall and decorative tiles, and refractory uses.

We believe, generally, that the device of employing the end use of a clay to determine the rate of depletion is unsound and will cause confusion. It would be far better, if possible, to write into the law the specifications or criteria which will precisely describe the type of clay which is to receive 5 percent and the type which is to receive 15 percent depletion.

We recognize the difficulty of securing agreement on such criteria, however. We would, therefore, as an alternative, recommend that

section 613(b)(5)(B) be rewritten to eliminate the phrase "and kindred products"; that is, to read:

> (B) clay used, or sold for use, in the manufacture of building or paving brick, drainage and roofing tile, sewer pipe, and flower pots.

Item 2: Section 613(c)(4)(A) includes "fine pulverization" as a treatment process not considered mining. We believe this term to be too vague and that it should be deleted. We pulverize to some degree most of the clay we sell, but we do not know whether it is "finely" pulverized or not within the meaning of the term "fine" as used in the new bill.

Item 3: The new bill would provide a new section 613(c)(4)(B) as follows:

> Notwithstanding any other provisions of this subsection, any treatment process which follows a process that is not considered as "mining" will not be considered as mining for the purpose of this subsection.

This entire section should be deleted. It is a catchall provision which catches much more than it reasonably should. The limits of its effect would depend on the individual practice of the particular taxpayer as to the chronological occurrence of the process in question, in relation to his other treatment processes. This chronological sequence might not be the same for any two taxpayers so that one would be allowed a process and the other would not, although the processes are identical.

Moreover, the proposed provision is inconsistent with subsection 613(c)(3)(C)(v) which specifically provides that "loading for shipment" is a treatment process properly to be considered as mining. Obviously, loading for shipment is the final treatment process but, if the objectionable provision is allowed to remain in the bill, it would, wherever effective, inevitably operate to disallow "loading for shipment" and might well disallow other treatment processes, such as bringing the "ore to form and condition suitable for shipment," which are expressly included as mining processes in the earlier clauses of the bill. Endless confusion could result.

The CHAIRMAN. Are there any questions of Mr. Pitts?

If not, Mr. Pitts, we thank you, sir, for bringing us your point of view.

Mr. PITTS. Thank you.

The CHAIRMAN. Our next witness is Mr. Kenneth K. Luce.

Mr. Luce, will you identify yourself for the record, please, sir.

STATEMENT OF KENNETH K. LUCE, REPRESENTING WISCONSIN DIMENSION STONE INDUSTRY, INC., AND HALQUIST LANNON STONE, CO., MILWAUKEE, WIS.

Mr. LUCE. Mr. Chairman and members of the Ways and Means Committee, my name is Kenneth K. Luce. I am a member of the law firm of Michael, Spohn, Best, and Friedrich in Milwaukee, Wis. We represent a number of producers of crushed stone and building stone in the limestone industry in southern and central Wisconsin.

I am here this morning representing the Wisconsin Dimension Stone Industry, Inc., a trade association of building stone producers in that area, and in particular the Halquist Lannan Stone Co., located in Waukesha County, Wis.

I have submitted a statement here and I do not intend to read it word for word, but I feel that I can do better perhaps if I speak as much as I can away from the statement.

The CHAIRMAN. Without objection, however, your entire statement will appear in the record if you desire it.

Mr. LUCE. I would like it to appear in the record.

Percentage depletion should be a method for computing a deduction for depletion which will cut through many of the problems which are involved in determining cost or discovery depletion and which will permit a simple computation of the depletion allowance. This is possible so long as the percentage rate is applied to a readily determinable income figure. If it is applied to the gross income from the sales of a product which the taxpayer actually produces and sells, it is apparent that the method will permit of a relatively simple computation.

If the taxpayer processes his product beyond the stage for which there is a ready market and depletion is computed on the gross income which he would have received had he sold his mineral at an earlier marketable stage, it is still relatively easy to determine the income figure on the salable product for purpose of computing depletion.

The existing statute permits this simplified type of computing depletion in defining mining to include ordinary treatment processes normally applied by mine owners in arriving at a commercially marketable product.

The Treasury Department's proposal for redefining mining, I submit, will result in far greater complexity and confusion than exists under the present statute. Under this proposal, many mine operators will be required to compute depletion on a gross income from a product which they do not produce or sell and which in fact may not even be marketable.

It will be necessary to determine an arbitrary gross income from a theoretical sale of a product for which there is no market, and this will reintroduce all of the complicated valuation problems that were inherent in discovery depletion and cost depletion.

I submit that if it is necessary and desirable to reduce percentage depletion allowances in order to prevent serious revenue losses, it should be done in a straightforward manner by a reduction in the rate applied to each mineral, rather than by attempting this redefinition of mining. Any attempt to redefine mining, especially with the approach that is being adopted here, will throw this whole field into turmoil again and we can anticipate another 10 or 15 years of litigation to straighten it out.

I would like to apply the Treasury's proposed definition of mining to the limestone industry, with which I am somewhat familiar, in order to provide an example of the inequities which this proposal will work within at least one industry.

The production of dimension stone, building stone if you please, from a quarry is a process of extracting the stone from the quarry and breaking and cutting it into dimensions suitable for building purposes. All dimension stone producers are engaged in this activity in one form or another.

However, the method by which they extract and cut the stone may differ, depending upon the hardness of the stone, its character, and the way it lays in the bed. Monolithic stones, such as the stone produced

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in the Bedford limestone area of Indiana, can be cut to rather exact dimensions right out of the wall of the quarry. They do it through the use of so-called channeling machines, which cut the stone directly out of the quarry in huge blocks, and these blocks when they come from the quarry are substantially in form to be sold and shipped to people in other areas who cut the stone to the dimensions they require for building in those other areas. There is very little waste involved in cutting this monolithic limestone out of the wall of the quarry and so your extraction process, your process of extracting the stone from the wall of the quarry, produces itself a salable product.

In contrast, the stone produced, also limestone, in the Wisconsin area from which I come is not a monolithic stone, but a stratified stone, laying in natural beds or layers from 1 to 30 inches, and cut in many irregular places by vertical fractures. That is the way the stone is made in nature. I have described the process of extracting and cutting this stone in my statement in some detail and I do not intend to go into that detail here at this time unless you so desire. But, fundamentally, the process is to bore holes and have a light charge of black powder that will just jar the stone enough so that it can be removed, and as this dolomitic limestone in southern Wisconsin comes out, it comes out in slab that are very irregular; as I said, from 1 to 30 inches in thickness.

Then those slabs must be cut, either with saws or through traditional methods with chisels and hammers, into the dimensions that are necessary to make the stones salable as building stone.

The Treasury proposal permits all extraction processes to be included as mining. Then it proceeds to list certain mining processes that are to be considered mining processes and certain mining processes that are not to be considered mining processes.

One of the processes that they name that is not to be considered a mining process is shaping. We believe that the cutting we do, the cutting and sawing of these slabs after they are removed from the wall of the area, to be a part of extraction basically. However, I have had some experience with the Commissioner of Internal Revenue and I know that if this statute is passed, it will be contended that the cutting processes that are carried on in southern Wisconsin in the dolomitic limestone area, the cutting of these slabs after they are removed from the wall of the quarry, are shaping and that the cost thereof is not to be included as mining, whereas in Bedford, Ind., in the limestone district there, the extraction process indubitably includes the shaping process, and so you will have here a discrimination in the percentage depletion allowances between two parts of the limestone dimension stone industry, between Indiana and Wisconsin, which I really cannot see any sense to.

I think it is fortuitous. I think it is an unjust discrimination and I suspect that it is a discrimination that the Treasury Department itself is not aware of, but it will come if this type of specific definition of mining processes is attempted in this statute.

One of the reasons for the difference, I might add here, is that the Bedford limestone is almost entirely calcium carbonate and it is a much softer limestone than the dolomitic limestone in southern Wisconsin, which is about 51 or 52 percent calcium carbonate and about 42 percent magnesium carbonate, which makes a stone almost as hard as granite as distinguished from the stone in Bedford, Ind. That

is one of the reasons it comes out as it does and why in Bedford, Ind., they can channel the stone out in large blocks, because it is monolithic and it is a softer stone.

So from this brief description of the processes normally employed by mine owners in quarrying limestone, it can be seen that the cutting and breaking processes are closely related to the quarrying of the mineral.

A reading of this proposed statute of the Treasury Department leaves me with the impression that the bill was drafted without any thought being given to its application to our industry, without any knowledge of our industry. This might be understandable because our industry is a small part of the limestone industry and an even smaller part of the stone industry as a whole. Nevertheless, the law must be applied by the taxpayers that I am representing from this industry to their individual circumstances.

There are undoubtedly many other segments of the mining industry in which the Treasury's proposed definition of specific mining processes may apply with similar inequity. If a definition of mining is to be enacted which will specify each of the mining processes for each of the many mining industries in the United States, large or small, it seems necessary that consideration be given to the specific problems of each of these industries.

The Treasury's proposal reveals that no such consideration has been given to the problems of our small industry as compared with the Indiana limestone industry or the dimensional stone industry as a whole. Certainly this must be only a single example out of many.

We submit that any attempt to define mining specifically for each industry can only result in failure to anticipate the problems of a great many taxpayers.

In conclusion, there has been considerable said here this morning about creating litigation and I point to subsection (3) of section 613(c), where they are listing specific mining processes that will be admitted to be mining and they say that they have a catchall phrase here:

> * * * any additional process, if necessary, to bring the mineral to a condition suitable for shipment.

Then further down:

> The processes referred to in (iv) are those processes which are necessary to bring the mineral or ore to the physical form and condition in which it is capable of being transported as distinguished from those processes applied to make the mineral or ore salable.

Gentlemen, what is "capable of being transported"? As a lawyer, I know that if that one goes through you will have litigation till hell freezes over.

What is "capable of being transported"?

I submit that that isn't the question to the taxpayer or the businessman. The question to him is: What is capable of being transported economically to market?

You don't transport things just because they can be loaded on a freight car, and most anything can. What does this mean?

To me it is a fruitful source for litigation. The definition of that is anything capable of being transported. Whether it is economically practical to transport it is one thing, but that isn't what this says.

I have not taken my full time, but I think I have made my point. I have submitted a statement for you and if you have any questions, I would be glad to try to answer them.

(The statement referred to follows:)

STATEMENT OF KENNETH K. LUCE

My name is Kenneth K. Luce, and I am a practicing attorney in Milwaukee, Wis. I am appearing here representing the Wisconsin Dimension Stone Industry Association and the Halquist Lannon Stone Co., located in Waukesha County, Wis.

H.R. —— which has been prepared by the Treasury Department proposes that Congress should enact a new definition of mining for purposes of computing percentage depletion. We would like to discuss briefly the effect of this proposal on the determination of depletion in general and on the determination of depletion for the limestone and building stone industries specifically.

Percentage depletion should be a method for computing a deduction for depletion which will cut through many of the problems involved in determining cost or discovery depletion and permit a simple computation of the deduction. This is possible so long as the percentage rate is applied to a readily ascertainable income figure. If it is applied to the gross income from sales of a product which the taxpayer actually produces and sells, it is apparent that the percentage method will permit a simple computation of depletion. If the taxpayer processes his particular mineral beyond the stage for which there is a ready market and depletion is computed on the gross income which the taxpayer would have received had he sold his mineral at the earlier marketable stage, the computation of depletion is still fairly simple. Instead of using the taxpayer's actual selling price, it is necessary only to convert this selling price to the market price of the earlier marketable product. The present statute permits this simplified method of computing depletion in defining mining to include ordinary treatment processes normally applied by mine owners in order to obtain the commercially marketable mineral product.

In a letter to the Vice President of the United States and to the Speaker of the House of Representatives, dated January 26, 1959, the Secretary of the Treasury, Robert B. Anderson, referred to difficult and complex problems in determining the stage at which taxpayers first obtain a commercially marketable product. Actually, these complexities result not so much from the wording of the statute as they do from the Treasury Department's desire and attempt to reduce depletion allowed to amounts far below those contemplated under the statute. This indeed has resulted in complex problems for the Treasury Department, and the Treasury Department's attempts to limit depletion deductions have in turn resulted in many complex problems for individual taxpayers. In spite of the Treasury Department's claim of complexity in the present law, the courts have succeeded fairly well in defining commercially marketable product in numerous cases in a number of mining fields, although not always to the satisfaction of the Treasury Department.

The Treasurer's proposal for redefining mining will result in far greater complexity than that contained in the present statute. Under the Treasury's proposal for defining mining, most mine operators will be required to compute depletion on gross income from a product which they do not produce or sell and which, in fact, is not marketable. Thus it will be necessary to determine an arbitrary gross income from a theoretical sale of a product for which there is no market. This will reintroduce all of the valuation problems inherent in discovery depletion which Congress has previously bypassed by the percentage depletion deduction. We submit that if it is necessary and desirable to reduce percentage depletion allowances in order to prevent serious revenue losses, it should be done by a straightforward reduction in the rate applied to each mineral, rather than by attempting a redefinition of mining. Any attempt to redefine mining at this time will throw this whole field into turmoil once again, and we can then anticipate another 10 or 15 years of litigation to establish the meaning of the new law.

Perhaps the application of the Treasury's proposed definition of mining to the limestone industry will provide a good example of the inequities which this proposal could work within one industry. The production of dimension stone from limestone is a process of extracting stone from a quarry and cutting and breaking it to dimensions suitable for building purposes. All dimension-stone producers

are engaged in this activity in one form or another. However, the method by which they operate differs depending upon the nature of the stone which they quarry. Monolithic stones such as the oolitic limestone produced in Indiana can be cut to rather exact dimensions in the extraction process. Mechanical devices for cutting or sawing the stone are employed to cut slabs or blocks having a uniform size and shape directly from the stone deposit. Accordingly, the stone at this stage in the processing has a relatively high value per ton, readily acertainable since the stone is frequently sold in this form.

In contrast, the stone produced in the so-called Lannon stone district in Waukesha County, Wis., is a stratified stone broken by natural bedding planes and also broken by vertical fractures. It is not possible to shape this stone at the same time that it is extracted since it must be taken out of the quarry in the shapes and sizes in which it occurs in nature. These sizes are substantially smaller than the blocks or slabs of stone which are cut directly from the quarry in the Indiana limestone district. Furthermore, they are irregular-shaped pieces.

In order to produce a salable dimension stone and one which is comparable to the slabs of Indiana stone from these pieces, they must be further cut and broken until they have assumed roughly the dimensions required for building purposes. Even at this finished stage most of the stone produced from this district is of more irregular shape than the blocks or slabs cut by the Indiana limestone producers directly from the quarry. The average value of these finished products is comparable to the value of the blocks or slabs of stone produced in the Indiana limestone district.

The Treasury proposal permits all extraction processes to be included as mining. However, any shaping, other than shaping accomplished during the extraction process, is not allowed as a mining process. Although we believe the cutting to be merely a part of the extraction process, the Treasury, in view of their present policies, could be expected to contend that it constitutes shaping rather than extraction. In the limestone industry this might result in permitting a producer of Indiana limestone to compute depletion on gross income from the sale of dimension stone which has been shaped during the extraction process to uniform dimensions, whereas producers of Lannon stone would be required to exclude from their mining processes the shaping of their stone to a dimension suitable for building purposes. This would be an unwarranted and fortuitous discrimination between producers of dimension stone in different parts of the country. This sort of inequity is bound to occur if an attempt is made to define mining by specific inclusion of only certain processes.

Such an approach to a definition of mining, to achieve fairness, would require that the statute be tailored to fit every possible industry and mineral for which depletion is to be allowed. The Treasury proposal does not do this and attempts only to apply a few specific descriptions of processes to a great variety of mines and minerals, to many of which the specific descriptions just do not fit. The existing statute is a more honest approach, since it does not purport to do more than set forth a general definition of mining. The generality of the existing statute is what makes it workable in applying it to so many diverse mining processes.

The failure of the Treasury's proposal to adopt a definition of mining which will be workable and fair when applied to all mines and minerals can also be illustrated by its utter lack of application to the quarrying of dimension stone in Wisconsin. Such illustration requires some explanation of the processes used in the quarrying of such stone. As I have mentioned, the dolomitic limestone quarried in Wisconsin for dimension stone purposes is a stratified stone and it occurs naturally in beds varying from 2 to 30 inches in thickness. Most of this stone quarried in Wisconsin is broken by natural vertical fractures and thus the quarries simply do not contain large slabs or blocks of stone. This stone exists in relatively small, irregular shaped pieces, and the quarrying process consists of removing these irregular pieces and cutting them into regular sized pieces.

The normal method of quarrying is to drill vertical holes behind the face of the quarry, if possible along one of the vertical fractures. Very small charges of black powder are placed in the drilled holes and then detonated. The small blast which occurs is sufficient to nudge or loosen the pieces of stone along their natural bedding planes and vertical fractures. They are then removed simply by wedging them up with wedges or crowbars.

At this point the stone has been removed from the remainder of the deposit. However, it does not yet have the character of dimension stone as there is no uniformity in the size or shape of the pieces. Production of dimension stone

from these pieces involves further breaking and cutting which closely approximates the quarrying process. One method of breaking is to score the stone along the line on which a break is desired. Small holes are then drilled in the stone along this line and approximately 6 inches apart. Wedges are inserted and are struck alternately with a hammer until the stone splits. This is called pegging and feathering. A variation of this method is called bull wedging, which is used on smaller pieces of stone. Again the stone is scored and a small hole about three-fourths of an inch deep is chiseled along the scored line, usually at the thickest part of the stone. Two shims are placed in the hole and a small wedge about 1 inch high is placed between them. A sharp blow struck on this wedge will split the stone along the scored line if there is no interior defect in the stone.

Some stone can be broken simply by hitting it with a hammer or sledge hammer, depending upon its size, after first scoring the stone. The scoring is accomplished either by a type of chisel called a tracer or by a small hand saw employing circular carborundum blades.

After the stone is broken in this manner to sizes suitable for building purposes, the pieces may then be trimmed or dressed by the use of hammers and chisels. In this process the stone is not cut or broken to exact dimensions.

Large saws which can cut completely through the stone are now being employed to some extent in producing veneer type building stone. This is principally a labor saving device and accomplishes the same thing as the cutting and breaking which I have just described. However, through the use of mechanical saws, the stone acquires more uniform dimensions. Because of the labor saving achieved through use of these larger saws, the overall cost of cutting by this method is not any greater than that invloved in the hand cutting operation.

A number of years ago it was common for stone to be sold in rough form to stone masons who cut the stone to the required dimensions at the jobsite. This is no longer done, principally because the stone masons could not economically transport the rough stone to the jobsite, cut it and dispose of the waste. In reducing the piece of stone taken from the quarry to dimension stone, approximately 50 percent of the original piece is lost. This waste creates a serious disposal problem for anyone who attempts to cut the stone away from the quarry. At the quarry the operator can dispose of the waste by back-filling it into the pit or by feeding it into a crusher. Furthermore, the shipment of finished dimension stone does not require the payment of transportation costs on the waste. It can readily be seen that transporting the rough stone for further processing away from the quarry is economically impractical because it involves the payment of shipping costs on twice as much bulk as is included in the end product. This is only one of the several distinctions between the Wisconsin limestone industry and the Indiana limestone industry. The nature of the Indiana oolitic limestone permits it to be machine cut with no more than 5 percent waste between the mill block or slab and the finished building stone.

Another distinction between the Wisconsin limestone and the Indiana limestone is the relative hardness of the two stones. The Indiana limestone is a fairly soft stone which is easily cut. In fact, it cuts easier after it has been permitted to season or dry for a period of time after quarrying. The Wisconsin dolomitic limestones, on the other hand, should be cut immediately after quarrying. This stone begins to dry and lose its natural moisture as soon as it is removed from the quarry deposit, and after it dries it becomes brittle and harder to process. This also makes it uneconomical to carry on processing at any distance from the quarry.

From this brief description of the processes normally employed by mine owners quarrying limestone for use as building stone in Wisconsin, it can be seen that the cutting and breaking processes are closely related to the quarrying of the mineral. In fact, no dimension stone can fairly be said to have been extracted from the quarry until it has been processed to relatively uniform dimensions. A reading of the Treasury's proposed statute, however, leaves us with the impression that the bill was drafted without any thought being given to its application to our industry and without any knowledge of our industry. This might be understandable because our industry is a small part of the limestone industry, and an even smaller part of the stone industry as a whole. Nevertheless, the law must be applied by the taxpayers whom I am representing from this industry to their individual circumstances.

There are undoubtedly many other segments of the mining industry in which the Treasury's proposed definition of specific mining processes may apply with

similar inequity. If a definition of mining is to be enacted which will specify each of the mining processes for each of the many mining industries in the United States, large or small, it is absolutely necessary that consideration be given to the specific problems of each of such industries. The Treasury's proposal reveals that no such consideration has been given to the problems of our small industry as compared with the Indiana limestone industry or the dimension stone industry as a whole. Certainly this must be only a single example out of many. We submit that any attempt to define mining specifically for each industry can only result in failure to anticipate the problems of a great many taxpayers. Accordingly, the existing general statutory definition of mining should be retained because it has been subjected to a long process of interpretation by many courts and now furnishes a reliable and equitable guide for the courts in their application of the depletion statute.

SUMMARY

The present statutory definition of mining in section 613(c) of the Internal Revenue Code should be retained. Its generality permits it to be applied with fairness to all mineowners regardless of the uniqueness of their mineral or mining methods. The Treasury proposal attempts a specific definition which simply will not fit the situations of many mineowners. One example of this is the failure of the statute to consider and deal with the unique problems of the Wisconsin dimension stone industry.

The CHAIRMAN. Are there any questions of Mr. Luce?

Mr. Simpson will inquire, Mr. Luce.

Mr. SIMPSON. Mr. Luce, I am sorry I was late.

Is your thinking of the nature of retaining the existing provisions of law, that what you are undertaking to obtain, is a commercially marketable mineral product?

Mr. LUCE. Yes, I think that is fair.

Mr. SIMPSON. In the instance of Indiana limestone, and I mean that which comes from Indiana, which you described as monolithic I believe, it is easier to get out in block and in that case the commercial product is more or less at the moment it is gotten from the face of the quarry and transported?

Mr. LUCE. That is right.

Mr. SIMPSON. In the other instance, you would allow the first commercially marketable mineral product to include getting it from the face of the quarry and processing it until it is in a salable condition.

Mr. LUCE. That is right.

Mr. SIMPSON. Therefore, we are not troubled with the definition of mining then as such?

Mr. LUCE. No, except that the present statute says, I believe, those processes ordinarily used by mines in producing their first marketable product, and as it reads now, we feel that our cutting processes, which are essential to produce a salable product, are mining processes. We feel that the word "shaping" in this proposal would give the Commissioner an opening.

Mr. SIMPSON. In the absence of those treatments after getting the rocks from the face of the quarry in Wisconsin you do not have the commercially marketable mineral product?

Mr. LUCE. We certainly do not.

You have a slab of stone from 2 to 30 inches thick that is very irregular and very rough, and that must be taken either to a cutter's table and cut through the use of scoring saws, and bull wedging, and various processes with hammers and chisels, or to a saw shed where they use wire saws and diamond circular saws to cut the stone into veneer, and sills, and other building products.

Mr. SIMPSON. I understand.

Thank you very much.

The CHAIRMAN. Mr. Mason will inquire.

Mr. MASON. I do not want to inquire, Mr. Chairman, but I do want to call the attention of the chairman and all the members of this committee to the fact that each of the five witnesses this morning, each one of them, has called the attention of this committee to the fact that the new definition or mining manufacturing formula that the Treasury wants will throw not only yourself, Mr. Luce, but all these various types of industry into a mess, and it would result in a tremendous amount of new litigation, and it would further complicate the problem of finding a proper base for depletion. So in view of that, I think, Mr. Chairman, that we better think twice before we change the base for our depletion.

Mr. LUCE. I don't think there is any question about that, Mr. Mason.

The CHAIRMAN. Mr. Curtis will inquire.

Mr. CURTIS. Just one question.

After you have gotten your product from Wisconsin lime and Indiana lime, is the price the same?

Mr. LUCE. The value per ton is substantially the same, although our product is a much smaller product than the Bedford product. Our end product, salable product, is stone veneer that is used in building homes, and all these big blocks you see in big buildings is Bedford stone. It comes out in big blocks. We can't make a big block.

Mr. CURTIS. In other words, actually you are not in direct competition for the same use?

Mr. LUCE. Not for the same type of building.

Mr. CURTIS. Thank you.

The CHAIRMAN. Are there any further questions?

Mr. Alger will inquire.

Mr. ALGER. Mr. Luce, on page 7 you point out that this proposed law was written without the knowledge apparently of your industry. The gentleman from the Treasury, Mr. Lindsay, appeared before us and gave us an example of the inequities now being worked under depletion, as, for example, crude iron ore can be reduced into pig iron and pig iron can be worked up the ladder to steel bolts with terrific differences in depletion allowances, about as much as 18, 20 times over.

Do you see that example of an inequity, which most of us would agree is inequity, as comparable at all to your situation?

Mr. LUCE. Hardly, because in building stone you don't have those different steps where you have various salable products.

Mr. ALGER. You see the problem the Treasury faces?

Mr. LUCE. I understand.

Mr. ALGER. This is where the problem starts.

The Treasury states what it has in mind and it runs headon into your problem this morning which presents an entirely different picture.

That leads me to my next question, which I draw from page 4, where you say it is necessary, as you see it, that the statute be tailored

to fit every possible industry and mineral for which depletion is to be allowed.

I have been listening to each of these companies and each of them impresses me that they feel themselves to be unique with unique processes even as they have unique material that they are working with.

Do you think that any statute that does not deal with all possible situations will satisfy the needs of your depletion allowance? Do you think any general law could be applied to all of the industries?

Mr. LUCE. I feel this: that the approach of this statute is basically wrong, that it attempts to list what are mining processes, and when you start that it seems to me that you have to go on to all the mining industries with all their peculiar problems, which to me poses an insuperable and impossible job. That is why I say that the approach is wrong.

Mr. ALGER. Then you say:

The generality of the existing status is what makes it workable in applying it to so many diverse mining processes.

Then obviously we have to rely on the Treasury's judgment if we do not spell it out? Is that not correct?

Mr. LUCE. Yes. It seems to me in spite of what the Treasury says that the courts have been marking out the limits of the first marketable product pretty well in many fields of mining over the past 10 years.

Mr. ALGER. I would like to conclude then with this thought that I gather from page 2. All of this hangs together in my mind, because you say:

We submit that if it is necessary and desirable to reduce percentage depletion allowances in order to prevent serious revenue losses, it should be done by a straightforward reduction in the rate applied to each mineral, rather than by attempting a redefining of mining.

Does it not seem consistent to you that if the formula is inequitous in its present system, these inequities should be worked out industry by industry before you start talking about rate reduction; otherwise you are perpetuating the mistake?

Mr. LUCE. I am not sure that there are serious inequities under the statute as it is currently being interpreted, although I am not familiar with the steel industry, I must say. I am not familiar with iron and steel.

You say the Treasury has contended that there are inequities in that particular area?

Mr. ALGER. There are a number of court cases pending that say the same thing.

Thank you, Mr. Chairman.

The CHAIRMAN. Are there any further questions of Mr. Luce?

If not, Mr. Luce, we thank you, sir, for your discussion of the subject matter before the committee.

Mr. LUCE. Thank you.

The CHAIRMAN. Our next witness is Mr. W. N. Williams.

Mr. Williams, please identify yourself for the record.

STATEMENT OF W. N. WILLIAMS, VICE PRESIDENT, FOOD MACHINERY & CHEMICAL CORP.

Mr. WILLIAMS. Mr. Chairman and members of the committee. I am W. N. Williams, vice president of the Food Machinery & Chemical Corp. Food Machinery is engaged in the extraction and treatment of certain minerals in various parts of the United States, principally trona, commonly known as soda ash, phosphate rock and barytes.

Food Machinery is a member of the American Mining Congress which has presented its views on the Treasury proposal to this committee, and, generally, we are in accord with the views stated by its spokesman.

We do not oppose the position taken by the Treasury Department in its proposed legislation to eliminate the commercially marketable mineral product test for percentage depletion.

In addition to the comments made on behalf of the American Mining Company with respect to the drafting of the provisions of the bill, we wish to call the attention of the committee to certain other drafting matters.

The bill specifically designates certain treatment processes in general terms which shall be considered mining for depletion purposes. Insofar as this language is intended to be exclusive and would preclude the Treasury Department from adding or further specifying treatment processes which should be considered as mining, we wish to take exception to this aspect of the bill.

In the past, as technological changes in the processing of minerals and ores have developed, the Commissioner of Internal Revenue has taken cognizance of such changes in technology by recognizing additional processes as ordinary treatment processes. New processes may develop which may be regarded by the Treasury as essentially extractive and not manufacturing, and therefore properly includible in the term "mining." It would seem desirable to authorize the Commissioner of Internal Revenue to specify additional treatment processes which may be considered mining.

I wish also to call the attention of the committee to an ambiguity in the provisions of the bill insofar as they relate to the processing of trona or soda ash. In the extraction of the soda ash from the mineral, there is a process of drying and decarbonation which the Treasury, under its present administrative practice, recognizes as an ordinary treatment process allowable for depletion purposes.

Mr. David A. Lindsay, Assistant to the Secretary of the Treasury, in the March 5, 1959, hearings on this proposed bill, stated that the Treasury did not intend to change this administrative practice and intended that the drying and decarbonation of trona, or soda ash, continue to be considered mining under the bill.

There appears to us to be some doubt as to whether the language of the Treasury bill makes it sufficiently clear that this process will continue to be included as a mining process in accordance with present administrative practice. However, we do not request that the bill be amended specifically to add to the processes specified in paragraph (3), the drying and decarbonation of trona, or soda ash.

In view of the testimony of the Treasury Department representative on this bill, we feel that the intent of Congress would be more fully

expressed if appropriate statements recognizing this process as a mining process were contained in the committee's report on the bill.

The CHAIRMAN. Are there any questions of Mr. Williams?

If not, Mr. Williams, we thank you, sir, for appearing before the committee.

Mr. WILLIAMS. Thank you, sir.

The CHAIRMAN. Our next witness is Mr. Charles A. Specht.

Mr. Specht, please identify yourself for the record.

STATEMENT OF CHARLES A. SPECHT, PRESIDENT, MINERALS & CHEMICAL CORP. OF AMERICA

Mr. SPECHT. Mr. Chairman and gentlemen of the committee, my name is Charles A. Specht. I am president of Minerals & Chemicals Corp. of America, which company is principally engaged in the business of mining and processing china clay and fullers earth.

The term "china" is used herein synonymously with kaolin. In the china clay industry, this company is one of the largest and oldest producers in the country, having, through a predecessor company, been active for over 50 years.

In accordance with the specific request of the committee, we have consolidated testimony on these minerals wherever practicable. With respect to china clay, I am speaking on behalf of the major producers, among them Georgia Kaolin Co., Southern Clays, Inc., United Clay Mines Corp., Thiele Kaolin Co., and American Industrial Clays.

I would like to assure you that I fully appreciate the problem confronting this committee. The purpose of my appearance is to point out that the proposed amendment to the percentage depletion section of the Internal Revenue Code could be interpreted to irreparably damage the china clay and fullers earth industries.

President Eisenhower, in his budget message submitted to Congress on January 19, 1959, stated that the Treasury Department would recommend an amendment:

> * * * designed to prevent an unintended extension of percentage depletion allowances to the sales price of finished products.

The treatment processes which have been recognized for china clay and fullers earth under the existing provisions of the Internal Revenue Code have been mutually arrived at and agreed to with the Treasury Department and to the best of our knowledge and belief have never resulted in unintended depletion benefits.

Because of the complexities in the law and the need for Treasury Department personnel to familiarize themselves with the intricacies of a wide variety of dissimilar clay mining operations, much time, effort, and money have been consumed both by producers and the Government to achieve the present level of mutual understanding and agreement. This progress, attained with such great difficulty and expense, might be nullified by the proposed amendment and again the shadow of doubt and uncertainty would be cast.

Our specific objections to the proposed amendment are:

1. That it will create new questions and uncertainties on allowable mining processes and lead to another era of confusion and litigation.

2. That it will discriminate in favor of minerals that compete with china clay and fullers earth, or in favor of certain producers within the same industry where the sequence of processes may be different.

3. That it will threaten the continued existence of the china clay and fullers earth industries by placing domestic producers at a further disadvantage with foreign competitors in the domestic market and as well in foreign markets.

4. That it will impose indefinite and uncertain end-use tests on all clays.

In order to overcome these objections and avoid the innumerable complexities, inequities, and hardships that might result from the broad and sweeping changes proposed, we submit the following recommendations, the adoption of which, we believe, will preserve the objective of the Treasury Department:

1. Within the framework of the existing Internal Revenue Code list the unallowable processes for the specific minerals which are alleged to be obtaining unintended benefits, or

2. Alternatively, revise the proposed amendment as follows:

(*a*) Change the wording of proposed subsection (b) (3) (B) relating to the 15-percent depletion rate to segregate china and the other listed clays from other clay which is dependent for the allowance on its refractory properties. The reason for this suggestion is treated below under general heading (4).

(*b*) Delete the catchall words "kindred products" from subsection (b) (5) (B) to avoid possibility of wide misunderstanding.

(*c*) Delete the word "free" from the phrase "drying to remove free moisture" under the listing of allowable processes. This word has many meanings not universally applicable to all minerals.

(*d*) Delete subsection (c) (4) in its entirety and the subparagraphs thereunder which list the treatment processes not allowable. This factor would then be determined for each industry under the listing of allowable processes.

In connection with the alternative proposal, we are submitting as an appendix to this statement the proposed amendment rewritten to reflect the above recommendations. Further elaboration of our specific objections is brought out in the following detailed discussion:

1. Many new questions and uncertainties would develop: This proposed amendment lists a number of specific processes which will not be considered as allowable treatment processes. These named processes are subject to a wide latitude of interpretation, depending on industry practice and usage. Because of lack of uniformity of meaning even among leading technical authorities, these could result in inequitable treatment even among processors of the same mineral because of varying administrative interpretation in the several taxing districts. Needless to say, this could result in even more litigation than has existed.

For example, the meaning of "fine pulverization" is extremely elusive. What to one industry may be considered a finely pulverized mineral may to another be a coarse product. Similarly, the term "calcining" listed as a nonallowable process, is used in industry frequently to describe a process which is "drying to remove free moisture" specifically mentioned as an allowable process.

The nonallowable process "refining" which is generally defined as freeing from impurities, contradicts the allowable process of "beneficiation by concentration" which is defined by the amendment to mean "the application of processes solely for the purpose of eliminat-

ing waste, or separating the mineral or ore from other minerals or ores."

"Blending with other materials" is particularly subject to speculative interpretation as, for example, mixing with water or mixing with an additive to facilitate an ordinary treatment process, after which the water or additive is removed. There could be wide misunderstanding in these areas.

Such examples could be amplified, but I believe they serve to illustrate my point that no processor could ever be certain that what was intended to be allowed could not be interpreted as crossing that indefinite line separating allowable and nonallowable processes.

2. Discrimination in favor of competitive minerals: Because of the broad latitude as to the meaning of the described processes, it is conceivable that inequities could result simply because one mineral employs a specifically allowable process, whereas the competing mineral employs a process which may be interpreted to be nonallowable.

For example, talc, which is specifically allowed pulverization, competes with china clay in the important markets of paper coating, cosmetics, and paint.

There is no specific allowance for the milling of china clay to competitive particle sizes. If, because of administrative fiat and broad interpretation of terms, this milling of china clay was erroneously construed to be fine pulverization, the china clay industry could be placed at serious competitive disadvantages with the talc industry. Similarly, in important markets fullers earth competes with the mineral bentonite.

Bentonite is beneficiated by leaching, a specifically allowable process, whereas, because of an inherent difference in mineral structure a different process is utilized to obtain the competitive fullers earth product.

Under the proposed amendment, this process might erroneously be construed to fall within the nonallowable processes, in which event serious discrimination would result.

Inequities and discrimination could also result among producers of the same minerals by reason of the catchall provisions of the proposed paragraph 4 (B) which provides for the nonallowance of any process which follows a process that is not considered allowable. Because of varying practices among producers of the same mineral, there will be differences in operating techniques and process sequence.

If it is determined that a process is nonallowable, it could impose a hardship on any producer who performs such process early in his operation, and, conversely, work to the benefit of a producer who performed the identical operation at a later stage in processing.

"Loading for shipment," which is specifically listed as allowable, is generally considered a final operation in the sequence of processes. However, this catchall provision could well be interpreted to negate this process if loading for shipment occurred subsequent to a nonallowable process. Similarly, these same circumstances could apply to deny the allowable process of bringing the "mineral or ore to form and condition suitable for shipment."

This particular provision of the amendment would add to the confusion and uncertainty and possibly be interpreted to negate processes which are otherwise listed as allowable.

3. Threat of foreign competition: China clay and fullers earth deposits are comparatively scarce. High grade deposits of these minerals are found in limited quantities only in southeastern United States and these are being depleted at a faster rate than the discovery of satisfactory new deposits. Consequently, prospecting has been considerably accelerated in recent years and ever-increasing sums are being expended on exploration and drilling to discover new deposits. This, coupled with increased labor and other operating costs, has contributed to an unfavorable and ever-widening cost differential between domestic and foreign producers.

Furthermore, the china clay and fullers earth industries have never had Federal Government mining subsidies or similar aid granted to many other minerals industries. On the contrary, because of cheaper labor rates, lower transportation costs, and steadily diminishing protective tariffs, the American china clay industry in particular is forced to compete with subsidized imported clays, principally from the United Kingdom.

Significant in this respect is the fact that the import tariff rate on china clay has steadily diminished from the 1930 rate of $2.50 per ton to the present rate of $1.06 per ton, which is scheduled for further reduction. This has enhanced the competitive position of foreign clays in the American market.

It is anticipated that such imports will increase because of the further advantage offered by the St. Lawrence Seaway, which will permit foreign clays to reach the heart of the domestic market in Michigan, Wisconsin, Ohio, Illinois, and Minnesota at delivered prices which American producers will find it increasingly difficult to meet in the face of steadily increasing freight rates. This will also have a serious effect on American export business to Canada.

Because of the already existing economic advantages enjoyed by foreign clays, it is extremely important for the continued existence of the domestic china clay and fullers earth industries and for the continued employment of thousands of workers engaged in these industries that no changes be made in the percentage depletion section of the Internal Revenue Code which would permit an interpretation detrimental to or imposing crippling hardships on these industries.

4. End-use test for China clay: Insofar as the text of the proposed amendment relates to the depletion rate of 15 percent allowable to China clay and other specified clays, it may be misconstrued. Its wording may be interpreted to mean that this rate is allowable only if such clays are used or sold for use for purposes dependent on their refractory properties. If such were the interpretation and if the mineral were not otherwise used or sold for use for the enumerated common purposes, eligible for the 5-percent rate, this might exclude such clays from any depletion allowance.

We do not believe that such a possible exclusion is intended and that the text should be corrected to clarify the intention of the proposed amendment.

This amendment is further objectionable in that the limitation of 5 percent on clay used or sold for use in the manufacturing of "kindred products" is not specific and therefore could be subject to wide misunderstanding.

Thank you very much for your courtesy in alloting this time for my appearance.

The CHAIRMAN. Without objection, the appendix attached to your statement will be placed in the record at this point.

(The material referred to follows:)

APPENDIX

RECOMMENDED CHANGES TO TREASURY DEPARTMENT PROPOSED PERCENTAGE DEPLETION AMENDMENT

A BILL To specify processes which shall be considered mining for the purpose of computing percentage depletion in the case of minerals and ores, and to revise the depletion rates with respect to certain clays when used to make common brick and tile produces

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. DEPLETION RATE FOR CERTAIN CLAYS AND TREATMENT PROCESSES CONSIDERED AS MINING FOR COMPUTING PERCENTAGE DEPLETION IN THE CASE OF MINERALS AND ORES.

(a) DEPLETION RATE FOR CERTAIN CLAYS.—Subsection (b) of section 613 (relating to percentage depletion rates) is amended as follows:

(1) Paragraph (3) is amended to read as follows:

"(3) 15 per centum—

"(A) metal mines (if paragraph (2)(B) does not apply), rock asphalt, and vermiculite; and

[**"(B)" if paragraph (5)(B) does not apply, ball clay, bentonite, China clay, sagger clay, and clay used or sold for use for purposes dependent on its refractory properties."**]

"*(B) if paragraph (5)(B) does not apply, ball clay, bentonite, China clay, and saggar clay. Additionally, clay used or sold for use for purposes dependent on its refractory properties.*"

(2) Paragraph (5) is amended to read as follows:

"(5) 5 per centum—

"(A) gravel, mollusk shells (including clam shells and oyster shells), peat, pumice, sand, scoria, shale, and stone, except stone described in paragraph (6);

"(B) clay used, or sold for use, in the manufacture of building or paving brick, drainage and roofing tile, sewer pipe, flowerpots, [and kindred products;] and

"(C) if from brine wells—bromine, calcium chloride, and magnesium chloride."

(3) Paragraph (6) is amended by striking "refractory and fire clay".

(b) TREATMENT PROCESSES CONSIDERED AS MINING.—Subsection (c) of section 613 (relating to the definition of gross income from property) is amended as follows:

(1) Paragraph (2) is amended to read as follows:

"(2) MINING.—The term 'mining' means the extraction of the ores or minerals from the ground, the treatment processes considered as mining described in paragraphs (3) and (4) and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which such treatment processes are applied thereto as is not in excess of fifty miles, unless the Secretary or his delegate finds that the physical and other requirements are such that the ore or mineral must be transported to a greater distance to such plant or mills."

(2) Paragraph (3) is redesignated paragraph (5).

(3) Paragraph (4) is deleted and the following paragraphs are inserted in lieu thereof:

"(3) TREATMENT PROCESSES CONSIDERED AS MINING.—The following treatment processes where applied by the mine owner or operator with respect to the minerals or ores extracted from the ground by him shall be considered as 'mining':

"(A) In the case of coal—cleaning, breaking, sizing, dust allaying, treating to prevent freezing, and loading for shipment;

"(B) In the case of sulfur recovered by the Frasch process—pumping to vats, cooling, breaking, and loading for shipment;

"(C) In the case of all other minerals or ores—(i) where applied to crude minerals or ores—crushing, grinding, sorting, screening, washing, and drying

to remove [free] moisture; (ii) beneficiation by concentration, and the processes necessary thereto; (iii) beneficiation by cyanidation, leaching, crystallization, or precipitation, and the processes necessary thereto; (iv) any additional process, if necessary, to bring the mineral or ore to form and condition suitable for shipment; and (v) loading for shipment. For purposes of this subparagraph, the term 'beneficiation by concentration' means the application of processes solely for the purpose of eliminating waste, or separating the mineral or ore from other minerals or ores, by gravity, flotation, amalgamation, electrostatic means, magnetic means, or substantially equivalent processes. The processes referred to in (iv) are those processes which are necessary to bring the mineral or ore to the physical form and condition in which it is capable of being transported as distinguished from those processes applied to make the mineral or ore salable. The term 'loading for shipment' shall not include the cost of packaging unless otherwise provided for under (iv) nor shall it include the cost of containers, bags, or any similar items;

"(D) The pulverization of talc, the burning of magnesite, the furnacing of quicksilver ores, and the sintering and nodulizing of phosphate rock.

[(4) TREATMENT PROCESSES NOT CONSIDERED AS MINING.—The following treatment processes shall not be considered as 'mining':

["(A) In the case of all minerals or ores—electrolytic deposition, roasting, calcining, thermal or electric smelting, refining, polishing, fine pulverization, blending with other materials, treatment effecting a chemical change, thermal action, and molding or shaping, unless such processes are otherwise provided for in paragraph (3); and

["(B) Notwithstanding any other provisions of this subsection, any treatment process which follows a process that is not considered as 'mining' will not be considered as mining for the purpose of this subsection."]

SECTION 2. EFFECTIVE DATE.—The amendment made by this Act shall be applicable only with respect to taxable years beginning after December 31, 1958.

The CHAIRMAN. Are there any questions of Mr. Specht?

If not, sir, we thank you for presenting your views to the committee.

We will now hear from our colleague, the Honorable Richard H. Poff, of Virginia.

STATEMENT OF REPRESENTATIVE RICHARD H. POFF, OF VIRGINIA

Representative POFF. Mr. Chairman, I believe this honorable committee and the Congress would make a serious mistake if it should adopt the departmental recommendation concerning a modification in the percentage depletion allowance for brick and tile clay. Such a modification, I am convinced, would adversely affect both the industry and the Federal Treasury.

This allowance was first authorized by the Congress in 1951. After more than 4 years of litigation, the Supreme Court, by a denial of certiorari, affirmed the industry's position; viz, that the 5-percent depletion rate is to be applied to the selling price of burnt brick and tile. This position rests on the inescapable fact that prior to the completion of the manufacturing process the semiprocessed raw material has no market price or value to which the rate could be properly applied. In other words, at no preliminary or intermediary stage of the manufacturing process does the raw material become a "commercially marketable mineral product" within the meaning of the statute.

The Department proposal would modify the criteria in such a way as to restrict application of the depletion rate to the value of the raw material at the point it enters the pugmill. I wish each member of the committee might have availed himself of the opportunity I had last December to visit a brick plant in operation. Only by such a visit

could one properly appreciate the practical factors involved. After the raw material is mined, transported to the plant site, screened, sifted, and graded, it is carried by conveyor belt to the pugmill. At this point water is added to and mixed with the material before it enters the brick machine. At that point the material has no commercial value whatever. Even if it were possible at that point to remove it from the manufacturing process, there would be no interested purchaser either inside or outside the brick industry. Even if it could be utilized by a manufacturer of some other clay product, it could not be packaged and transported in its semifluid state at an economically feasible price. It has no value except as a semiprocessed brick material at the same plant where the pugmill is located. Obviously, the departmental proposal is not consonant with practicality.

There is yet another reason why the proposal is unrealistic. It would be impossible for cost accountants to agree what specific costs and what portion of general costs of operation were attributable to that phase of the manufacturing process prior to the pugmill stage. Such disagreements would be the source of a multiplicity of vexatious and expensive lawsuits. Obviously, the Internal Revenue Service is not equipped adequately to police compliance.

Not only is the proposal unrealistic, it is injudicious. At this critical moment in our Nation's economic history, it is imperative that the Government follow a tax policy designed to stimulate and not to strangle industrial expansion. The construction industry, one of the Nation's largest, directly or indirectly reaches into and materially affects the health of practically every other economic endeavor in America. While it is true that the brick and tile industry is only a small part of the parent construction industry, it is nevertheless an integral part. Moreover, as a small business it is one of the essential unit components of our private enterprise system.

Possibly it is true, as some have suggested, that the increased tax burden which this proposal would entail would be passed along to the home builder and the home buyer. Even so, does this justify the proposal? In an era of rising consumer prices, should Congress thus contribute further to the cycle?

It seems to me the better part of wisdom for Congress to encourage the growth of this small industry by maintaining the same tax policy envisioned by Congress in 1951. Such a policy will help to stabilize the sales price of the product, stimulate consumer demand, encourage plant expansion, and thereby provide more jobs and more income, all of which will broaden the tax base from which the Government ultimately will realize increased revenues which will more than offset the current estimated revenue loss.

To recapitulate, the departmental proposal seems unwise because:

(1) The semiprocessed raw material is not a "commercially marketable mineral product" at the pugmill stage and therefore has no value to which the depletion formula could be applied;

(2) Operation costs could not be accurately subdivided and allocated to the ante pugmill operation phase;

(3) The proposal would retard industrial growth, increase consumer prices, and reduce consumer demand; and

(4) The resulting economic stagnation would preclude the increased revenue which the Government can reasonably antici-

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pate from a broadened tax base if the present tax policy is maintained.

The CHAIRMAN. Are there any questions?

Thank you, Mr. Poff, for a very interesting statement.

The CHAIRMAN. Is there present in the room a witness in behalf of the Rush Creek Clay Co., of Junction City, Ohio?

Is there a witness in the room for the Columbus Clay Manufacturing Co., of Columbus, Ohio?

Is there a witness in the room for the Michigan Vitrified Tile Co., of Findlay, Ohio?

Is there a witness in the room for the Featherlite Corp., of Austin, Tex.?

Is there a witness in the room for the American Marietta Co., of Chicago, Ill.?

Without objection, witnesses for these concerns may extend their remarks in the record at this point if they desire to do so.

(The material referred to had not been received at time of going to press.)

The CHAIRMAN. This concludes the call of the calendar for today.

Without objection, the committee adjourns until 10 a.m. tomorrow.

(The following material was received by the committee:)

MONSANTO CHEMICAL CO.,
St. Louis, Mo., March 5, 1959.

Hon. WILBUR D. MILLS,
Chairman, House Ways and Means Committee,
House of Representatives, Washington, D.C.

DEAR MR. MILLS: This statement is submitted in lieu of a personal appearance at hearings before your committee on the subject of percentage depletion. We trust that you will be good enough to include it in the record of the proceedings.

As you know, the chemical industry spends a very large percentage of its sales dollar on research and development. A great proportion of the products which it sells today were not in existence 5 or 10 years ago and even larger number are made by processes which are quite new. Development is the life blood of the industry.

Companies in the field are also dedicated to the maximum efficient use of natural resources. We endeavor to follow this philosophy energetically in the hope that new processes and methods will either make available natural resources not previously usable or make such resources available at a lower price. *Both are in the interest of progress and conservation.*

In considering the Treasury's proposed bill modifying Internal Revenue Code, section 613, percentage depletion, we are concerned lest paragraph (c) (4) retard progress by permitting depletion to be taken only on present processes and methods of beneficiating and treating ores and minerals. This would, in effect, rule out the development of new and as yet undeveloped processes and methods.

Subparagraph (c) (4) (A) by disallowing such methods as "treatment effecting a chemical change" and "thermal action"—both broad phrases—could easily retard the development and use of new, more efficient treatment methods.

Subparagraph (c) (4) (B) by not permitting for purposes of computing percentage depletion processes which follow a disallowable one can also substantially hinder the development of methods of product recovery.

It is our understanding that the intent of the proposed Treasury bill is to define as accurately as possible the basis for percentage depletion; not to erect obstacles to the development of new processes and techniques in handling minerals and ores. We, therefore, recommend clarification or elimination of paragraph (c) (4).

Sincerely yours,

EDWIN J. PUTZELL, Jr.

UNITED STATES STEEL CORP.,
New York, N. Y., March 6, 1959.

Re proposed amendment of Internal Revenue Code, section 613.

CHIEF COUNSEL,
Committee on Ways and Means, 1102 New House Office Building, Washington, D.C.

DEAR SIR: We present the following suggestions and objections in regard to the proposed draft of legislation submitted by the Treasury Department for amendment of section 613 of the Internal Revenue Code.

IRON ORE

Since percentage depletion was first introduced, the iron mining industry has been allowed the treatment processes necessary to bring the ore to shipping grade and form. From the beginning this has been interpreted to mean that the product on which percentage depletion is allowable is beneficiated ore suitable for shipment and use in the blast furnaces. It is our understanding that the Treasury has no intention of disturbing this long-established pattern. Nevertheless, the proposed legislation will have such an effect. The bill now before your committee does not make it clear that percentage depletion on iron ore should be applied to a base which includes all the processes customarily applied by the iron mining industry to arrive at a product suitable for both shipment and use in blast furnaces, including as allowable treatment processes all processes through the agglomeration of iron ores, taconite and other fine ores and iron concentrates, and loading for shipment. Sintering, briquetting, pulverizing, and nodulizing should be clearly stated as allowable processes.

It will be most unfortunate and unreasonable if the established procedures of many years in respect to iron ore depletion are discarded as a consequence of the understandable attempt to get more reasonable depletion results in the case of more recently added depletable minerals. At the least, we believe the present language of I.R.C. section 613(c)(4)(C) should be retained as applied to iron ore in the past.

LIMESTONE

The proposed bill should but does not make clear the allowable treatment processes in the case of a limestone producer who mines or quarries, prepares and ships limestone for chemical, metallurgical, and other similar purposes. We do not refer here to limestone for cement or for the production of lime or for any purpose which requires any processes beyond the ordinary treatment processes employed at a limestone quarry where the final product shipped is limestone.

The bill should clearly state that such limestone producer should be entitled to all crushing, grinding, screening, and pulverizing ordinarily employed to arrive at a salable product. This is only what has been allowed as a matter of practice in the past. Any attempt to disallow pulverizing or fine grinding should be discarded. To permit grinding and exclude pulverization is to make a distinction without a difference. Grinding is a continuous process and it is virtually impossible to distinguish where grinding ceases and pulverization begins. Also to make a given quantity of any size stone necessarily results in pulverization of a part of the larger feed material. It is impossible to define fine pulverization. Even if it could be adequately defined, the difficulty in most cases of excluding costs attributable to pulverization would be almost insurmountable. The courts heretofore have rejected all attempts of the Treasury to exclude pulverization or fine grinding as an allowable process.

CEMENT

We understand it is the intent of the Treasury to allow cement producers depletion based on processes employed to produce the kiln feed. This is what was allowed under past administrative practice without regard to recent court decisions. The proposed bill does not accomplish such result. It should be revised to do so, clearly and specifically.

GENERAL

1. The word "free" should be deleted from the expression "free moisture" in the proposed section 613(c)(3)(C)(i). Drying to remove "free moisture" may often incidentally remove inherent moisture. Such a limitation on drying sets up unnecessary difficulties. The purpose of such limitation can be better accomplished in other ways.

2. It should be made clear that the prohibited blending with other materials in section 613(c)(4)(A) does not refer to the mixing of the various grades of the same or similar materials or to the addition of grinding aids or incidental additives utilized in connection with further processing, or necessary, though relatively minor, to have an acceptable product.

3. In section 613(c)(3)(C)(i) the word "crude" should be eliminated. Under a literal interpretation, an ore or mineral is "crude" only when it first comes from the mine. Strict application of this language would, therefore, result in allowance of only one of the named allowable processes, as thereafter the ore or mineral would no longer be "crude."

4. Section 613(c)(4)(B) should be modified so as not to exclude in every case all otherwise allowable mining processes if an unallowable or nonmining process precedes it. Such a rule may be quite proper when applied to processes which follow a manufacturing operation, but should contain exceptions to permit the allowance of processes normally viewed as mining.

5. The proposed bill should be appropriately modified to state clearly that all processes necessary, incidental or appropriate to allowable processes are likewise allowable even though unnamed.

6. In the definition of mining contained in section 613(c)(2) the word "means" should be deleted and word "includes" substituted, so that it is clear that the allowable processes include those named but are not exclusively restricted to them. It is essential that sufficient flexibility be kept in the statute so as not to penalize ingenuity or freeze technological advances in the mining industry.

7. Section 613(3)(c)(3) refers to processes "*necessary* to bring the mineral or ore to the physical form and condition in which it is *capable* of being transported" (italics added). This is too rigid. Under a literal field interpretation of this provision, no treatment process would be allowable. Most things which can be contained can be shipped. Few things cannot be contained. The language should be modified to insure a reasonable interpretation.

8. The first sentence of section 613(c)(3) should be modified to allow for mining on a contract or toll basis. This calls for some change in the language which reads "with respect to the minerals or ores extracted from the ground by him."

9. Under modern conditions, we believe the 50-mile transportation allowance in section 613(c)(2) is inadequate and should be extended to at least 100 miles.

10. We also believe the Secretary or his delegate should be allowed greater discretion in the allowance of transportation in proper cases. This can be accomplished by changing the expression in section 613(c)(2) of the proposed bill which reads "physical and other requirements" to "physical or other requirements."

* * * * * * *

In conclusion we suggest that before adoption of this bill, serious study should be given to alternative and less radical ways of meeting what we understand are the limited objectives of the Treasury. Practices and procedures acceptable to both the taxpayer and the Government have been built up around the present language of section 613. If possible, it would be desirable not to disturb these. There would be less danger of doing so thereby inviting fresh disputes and litigation if the old language could be retained but supplemented to accomplish the ends sought by this bill.

Respectfully yours,

W. L. HEARNE,
Director of Taxes.

(Thereupon, at 11:45 p.m., the committee recessed, to reconvene at 10 a.m., Wednesday, March 11, 1959.)

MINERAL TREATMENT PROCESSES FOR PERCENTAGE DEPLETION PURPOSES

WEDNESDAY, MARCH 11, 1959

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met at 10 a.m., pursuant to recess, in the committee room, New House Office Building, Hon. Aime J. Forand presiding.

Mr. FORAND. The committee will come to order.

The first witness on our calendar this morning is Hon. Carl Vinson, of Georgia.

Mr. Vinson, we are most happy to have you appear before us, and you may proceed.

STATEMENT OF REPRESENTATIVE CARL VINSON, OF GEORGIA

Mr. VINSON. Mr. Chairman, I appreciate the opportunity to appear before this committee today in regard to proposed legislation which would, if enacted, nullify the depletion allowance authorized by the Congress in 1951 for the brick and title clay industry.

As I read the proposed legislation, it is apparent that what the Treasury Department really seeks is an 80-percent reduction in the present depletion allowance authorized for the brick and tile industry.

Now I have been intrigued by the Treasury Department's approach to this problem. The witness for the Treasury Department said in his statement:

> **The Secretary of the Treasury has * * * submitted to the Congress two drafts of proposed legislation which we believe will resolve the difficult problems involved in determining the point at which to measure the amount of income which is derived from mining, or mineral extraction.**

The Treasury Department's statement then goes on to use farfetched and grossly exaggerated examples to indicate the extent to which this problem might extend under their line of reasoning. The Treasury witness also states that the language of the present statute—

> **creates substantial administrative problems, most of which stem from the definition of ordinary treatment processes in terms of processes normally applied to obtain "the commercially marketable mineral product or products."**

While it would appear that the Treasury Department is interested in attaining additional revenue, it is significant to note that one of their prime targets is the brick and tile industry.

Now, the brick and tile industry in this country involves fewer than 600 plants, with gross annual sales of about $250 million. I am advised that the depletion allowance claimed in 1957 was approxi-

mately $5 million, whereas the total depletion allowances on all deposits amounted to about $2,800,000 in that year. It is strange, indeed, that the brick and tile industry should become a primary target.

Congress, in its wisdom, put in the language which everyone seems to understand except the Treasury Department. Let me read to you the decision of the Circuit Court of Appeals of the Fifth Circuit in *United States* v. *Merry Brothers Brick and Tile Company*, 242 F. 2d 709:

> * * * This question is whether this court will depart from its decision in *United States* v. *Cherokee Brick & Tile Co.*, 5 Cir., 218 F. 2d 424, in which, affirming the judgment and approving the opinion of the U.S. District Court for the Middle District of Georgia, in *Cherokee Brick & Tile Co.* v. *United States*, 122 F. Supp. 59, we said, 218 F. 2d at pages 424–425 of the pertinent portion of section 114 of the Internal Revenue Code, 26 U.S.C.A. § 114(b)(4)(A, B): "The statutory language is clear and unambiguous, which is that gross income from mining must include the income from ordinary treatment processes which must be applied to the ore or mineral in order to obtain the commercially marketable mineral product, that is, the first product which is marketable in commerce. There is no provision in the statute for excluding any process before such a marketable product is reached. The only restriction is that the processes must be the ordinary treatment processes normally applied by mine owners or operators."

In this case, the court also approved certain statements contained in the brief submitted by Merry Brothers with regard to the intent of Congress concerning the method by which the depletion allowance would be determined.

The court approved the following language which appeared in Merry Brothers' brief:

> * * * instead of limiting the depletion deduction to a recovery of the cost of the natural deposit, Congress has chosen to allow the deduction to be computed as a stated percentage of the selling price of the "commercially marketable mineral product" the selling price of the mineral product for which a commercial market exists. It has done so by defining "gross income from the property" in section 114(b)(4)(B) to include not only the income derived from the extraction processes but also the income from processes applied to the ore or mineral, after extraction from the natural deposit, to obtain the commercially marketable mineral product. But in no sense does this mean that depletion is allowed "on" any of the processes or "on" the products produced thereby, or that such processes or products are "depleted." We feel that this simple analysis disposes of the Government's whole argument.

The net result of the decision, of course, was to sustain the position of the brick and tile industry as represented by the Merry Brothers' brief.

Now the courts of this country have been able to interpret the intent of Congress and the Supreme Court has denied certiorari, so the Supreme Court is satisfied with the opinions of the lower courts. As a matter of fact, I have been advised that there have been almost 30 cases tried in 4 different circuits, all of which have been won by the brick and tile industry. So when the Treasury Department comes to the Congress and says that this is an administrative problem and that the law has to be clarified to make it a little bit easier for them to understand, what the Treasury Department really is saying is that Congress did not know what it was doing when they said that depletion would be based on the first marketable product.

Now if Congress had wanted to place this depletion allowance on the value of the mud coming out of the ground in order to give the brick and tile industry a reasonable allowance to compensate for the depletion of the deposits, I assume that Congress would have placed

a 25 percent depletion allowance on the clay extracted from the ground.

But Congress, instead, placed a 5 percent depletion allowance in the law for the brick and tile industry based upon the first commercially marketable product.

The Treasury Department in its statement quoted the Supreme Court in *Halvering* v. *Bankline Oil Company* (303 U.S. 362) to the effect that "the purpose underlying the deduction for depletion is to compensate the taxpayer for the exhaustion of a mineral reserve."

Then the Treasury Department went on to say in its statement that—

> Consistent with this purpose, the Treasury Department has long interpreted the statute to mean that the gross income to be used in the computation of the depletion deduction is the gross income attributable to treatment processes equivalent to those specifically named in the statute. Accordingly, the Department has maintained that any other or further processing of the mineral to market a finished product should be disallowed as manufacturing or nonmining.

Then the Treasury Department went on to say in its statement that courts have placed a broader interpretation on the term "ordinary treatment processes" and the effect of these decisions is that "depletion may be taken on the costs and profits attributable to the production and sale of expensive manufactured products."

But to show the true intent of the Treasury Department's thesis on this subject, they use the brick and tile clay industry to illustrate their point because the courts have held that depletion shall be based upon the income from the sale of finished building brick.

Now let us see what the law says. Title 26, U.S. Code, section 114(b)(4)(B), says:

> * * * The term "mining", as used herein, shall be considered to include not merely the extraction of the ores or minerals from the ground, but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products.

Yet, in spite of what the Congress says, in spite of the fact that the courts have been able to interpret this clearly and without ambiguity, the Treasury Department states that they have substantial administrative problems in understanding the law.

All the brick and tile industry wants is to apply the depletion allowance authorized by the Congress to the first commercially marketable product.

The Treasury Department, having lost consistently in the courts on this language, have now decided that the best method of attack is to eliminate the depletion allowance determined on the basis of the first commercially marketable product and instead to use a value based upon the mud at the pug mill.

In effect, the Treasury Department is telling this committee that they did not know what they were doing when they wrote the law, and the courts in interpreting what the Congress intended did not know what they were doing.

The Treasury Department says the law had better be changed because they do not like to write regulations that are based upon law with which they disagree.

Mr. Chairman, I am not ready to turn over to the Treasury Department the authority for making the laws of this country, and particularly the tax laws. And if the Treasury Department cannot interpret

these laws properly, maybe it is about time they got people in the Treasury Department who can interpret the laws in the manner the Congress intends.

But there is a bigger problem involved in this subject matter, Mr. Chairman, which I think should be of interest to all of us.

Why is it that the brick and tile industry in this country is being singled out for particular attention by the Treasury Department?

Why does this little industry, which has a depletion allowance of about $5 million a year, have to suffer this constant persecution by the Treasury Department as indicated by the numerous court cases that have all been in favor of the brick and tile industry?

Is there perhaps some motive behind this approach which seeks to raise the whole question of depletion allowance by concentrating on a small industry so that the whole question of depletion allowance on all items can be made subject to further congressional action?

Let us look at the brick and tile industry for a moment.

How would you determine the value of the mud that comes out of the ground when it arrives at the pugmill? Who wants that mud other than the manufacturers of brick and tile? Oh, probably some kindergarten classes could use it for modeling purposes, but basically, the mud is of value only after some further action has been taken. Congress recognized that when they wrote the tax law in 1951.

Now supposing we follow the argument of the Treasury Department to its logical conclusion with regard to other items. Let us take oil as an example.

If there were no refineries in this country; if there were no processes for extracting the byproducts of oil when it comes out of the ground, what would a barrel of oil be worth at the wellhead?

How much is a barrel of oil worth? What determines its value? Obviously, its value is determined by what the market will pay for a barrel of oil, but if we had to disregard completely any processes that may be applied to a barrel of oil to make it marketable as the Treasury Department suggests with regard to the brick and tile industry, then how much is that barrel of oil worth?

How many automobile owners would buy that oil at the wellhead? They could not put it in their cars because it would not be usable so far as the oil itself is concerned. And it would not burn in the gasoline tank because it has not been refined. So who would buy the oil if there were no processes for making it a commercially feasible product?

Well, I am sure that there would be a few purchasers, just as there were back in 1850 before Mr. Drake drilled his well at Titusville, Pa. There would be some Indian medicine men who could use a barrel or two for concocting patent medicine; but I wonder how much effect this would have on the market value?

So if we are going to talk about the value of the mud at the pug mill before any further processing takes place, let us talk about the value of a barrel of oil if all further processing is completely disregarded. Let us determine how much demand there would be for oil if there were no refineries available to further process that oil.

Mr. Chairman, the Congress knew what it was doing in 1951, but the net effect of this whole matter is that the Treasury Department does not like the depletion allowance now in effect for the brick and tile industry. They want to eliminate it and probably others to come, but they want to attack one of the smallest industries first, and having

once eliminated the depletion allowance in this little industry, then they will go on to bigger and more profitable industries.

Mr. Chairman, when the Treasury Department decides that it is going to write the tax laws in this country, then I, for one, part company with the Treasury Department.

We have a sound, workable depletion allowance for this little industry and I urge this committee to permit this industry to continue on its way, letting it enjoy this small, insignificant depletion allowance so far as total revenues are concerned, but which makes it possible for these 600 little companies to engage in a business with an expectation of a reasonable profit.

I cannot help but feel, Mr. Chairman, that somewhere along the line the Treasury Department's pride has been hurt that the brick and tile industry has been successful in every court action so far as the depletion allowance is concerned.

These laws are invariably technical, to be sure, but here is a law that is clear to anyone who takes the trouble to read it. It has been clear to the courts of this country and it is so clear that the Treasury Department wants to change it. Apparently the Treasury Department does not like a law on the books which the courts have no difficulty in interpreting.

The very fact that the courts have interpreted this law so clearly is a tribute to this committee, and I urge that the committee retain the law with regard to the brick and tile industry just as it is now written.

Mr. FORAND. Thank you very much, Mr. Vinson. Are there any questions? If not, again we thank you.

Mr. MASON. Mr. Chairman. I would like to make an observation.

Mr. FORAND. Yes, Mr. Mason.

Mr. MASON. The witness, in my considered opinion, has absolutely demolished the Treasury's argument and position in this matter of depletion, and the witness has done that by sarcastic examples and has done it so completely that I do not see how this committee can go on considering this matter. I am perfectly satisfied to rest it right here without argument.

Mr. FORAND. The next witness on our calendar is Mr. Neill Boldrick, vice president of the Acme Brick Co. Come forward, please, sir.

For the purpose of the record, will you identify yourself and the gentlemen who are with you, sir?

STATEMENTS OF NEILL BOLDRICK, VICE PRESIDENT, ACME BRICK CO., FORT WORTH, TEX.; KENNETH W. DUNWODY, PRESIDENT, CHEROKEE BRICK & TILE CO., MACON, GA.; AND FRANK C. ERWIN JR., COUNSEL, ELGIN-BUTLER BRICK CO. AND ELGIN STANDARD BRICK MANUFACTURING CO., AUSTIN, TEX.

Mr. BOLDRICK. Thank you, Mr. Chairman. I am Neill Boldrick of Fort Worth, Tex., vice president of the Acme Brick Co. On my right is Mr. Kenneth Dunwody, president of the Cherokee Brick & Tile Co. of Macon, Ga., and also president of our Structural Clay Products Institute. On my left is Mr. Frank C. Erwin, Jr., an attorney of Austin, Tex., who represents the Elgin Standard Brick Manufacturing Co. and the Elgin-Butler Brick Co., both of Elgin, Tex.

Mr. FORAND. Do you desire to each present a statement, and then all be questioned at one time, or would you prefer the questions to come immediately after each one of your statements?

Mr. BOLDRICK. Mr. Chairman, in our desire to follow the recommendations of your committee, and in the conservation of time, we have coordinated our testimony so that we would not be repetitious and so each of us would speak on a particular phase of our problem.

We believe that some of the things that might occur to the committee as questions when I may testify and when Mr. Dunwody may testify may, perhaps, be answered by Mr. Erwin's statement, and we would, of course, be pleased to be questioned at any time, but in conservation of your time, perhaps questioning at the conclusion would be to that end.

Mr. FORAND. All right, sir. You may proceed.

Mr. BOLDRICK. Thank you, sir. I am Neill Boldrick of Fort Worth, Tex. I am vice president of the Acme Brick Co. of Fort Worth, and I am also chairman of the Depletion Committee of the Structural Clay Products Institute. I am appearing here on behalf of producers of brick and tile. The 447 companies in this industry operate 588 plants. These plants are located geographically in 47 of the 49 States and in the District of Columbia. You will observe the wide geographic distribution of our plants which must be located atop the best raw material available to economically supply the construction industry with the heavy products we produce.

We appreciate greatly the opportunity of appearing before you to present the position of our industry with respect to the legislation proposed by the Treasury affecting depletion for brick and tile clay. The Treasury's proposal is most drastic as it applies to our material, and it strikes heavily at the economic life of clay products producers. This proposal is not, as the Treasury has stated it is, a mere "technical amendment." Instead, at one blow, it would: (1) Emasculate the brick and tile industry's depletion allowance by taking away not just a little bit, but practically all, of such allowance; (2) destroy the present "first commercially marketable product" rule for determining the base for percentage depletion, which has been so wisely established by Congress.

As a spokesman for my fellow brickmakers, I request that the Congress reject the Treasury's proposed legislation and retain the "first commercially marketable product" as the base to which to apply our depletion rate.

Brick and tile clay is an aggregation of minerals. It is not true, as some have stated, that usable deposits are available everywhere, nor can it be located by just walking down a railway cut. In order to have usable brick and tile clay, it is necessary to find suitable clay which is accessible and which occurs in substantial quantities, near a market for the burned product. I want to emphasize that you cannot just go out in your backyard and dig up some dirt and use it for brick and tile. Only certain types of clay are suitable. Exploration and research are necessary to locate deposits of suitable clay. Even when you have found a deposit of suitable clay, it does not mean that you can locate a brick plant at this deposit. You have to find a deposit of sufficient size to justify the construction of an expensive plant, since it is not possible to transport clay any appreciable distance. The clay must also be accessible so that it can be extracted

from the ground economically; because of competitive conditions, it is not possible to use clay otherwise suitable if there is a large amount of overburden on it. Also, it is necessary to find a deposit located close to a market since the finished brick and tile are heavy products and costly to transport. We consider that our prime market for any given plant must be within 200 miles of that plant; in order to compete, we have to be able to sell the great bulk of our production in such an area.

To illustrate to you the difficulty of discovering suitable deposits of clay, I know of one company which recently spent 2 years and more than $50,000 fruitlessly looking for suitable clays at which it could locate a plant. Because they could find no such deposit, they were unable to locate in the market area which they desired to serve. Also, I would like to point out that in certain market areas there are no known deposits of suitable clay. A specific problem confronts my own company at the present time at our Houston, Tex., plant. We have exhausted our local supply of the type of clay needed in the manufacture of hollow building tile, and we have been forced to abandon the production of tile, curtailing our production and limiting that plant to building brick, while we search that area for suitable clay in geographic proximity to use in the resumption of tile production so that we may properly diversify our operation and supply this needed item to the building industry of the Houston area.

It may be of interest to you to describe the processes used to produce brick and tile. It is simply described.

The brickmaker goes into his pit, removes the overburden, and digs out his clay. This is, of course, in chunks of varying size and generally he subjects it to crushing of these chunks and some screening to remove roots and other vegetable matter. He then takes this clay and dumps it into a power-driven machine (called a pug mill) which mixes the clay with some added water. Then the clay goes into an auger-like machine similar to a meat grinder; this auger motion forces the mixture (which, in the meantime, has attained the consistency of a good mud ball) through the end of the machine, just as you would squeeze toothpaste from a tube, and this ribbon of extruded clay is cut by wire into brick or tile of the required shape. These shapes are then dried at 100 to 300 degree temperatures—sometimes at some plants this is done merely by action of the sun—and after drying it is placed in kilns and burned to complete the cycle. This then is a brick or tile.

This is an integrated process. At no point in the processing is there any product for which there is any commercial market. A brickmaker has no opportunity to sell his clay at any stage in this processing. It is only when it is finished as a brick or tile that it can be sold or has any market value. Prior to the completion of the process, the clay has value, of course, to the brick producer, but there is no ascertainable or established market value. We have never found any way to sell a clay ball or a piece of unburned brick or tile.

Thus, only when a brickmaker obtains his burned brick and tile does he have a product for which there is an established selling price or market value. In order to compute a percentage depletion deduction, it is necessary to have a dollar base to which to apply the depletion rate. Congress wisely selected the selling price or market value of the first commercially marketable product as this base. No other readily

determinable base has been suggested. In fact, to choose any other base is in our opinion "going all around Robin Hood's barn." The use of the first commercially marketable product rule does not give any unintended benefit to brick and tile producers; it only gives us the depletion deduction which Congress intended us to have.

To depart now from the simple first commercially marketable product rule would create new uncertainty and new issues which would have to be resolved by litigation. In order to save time and litigation expense both for the industry and the Government, we urge you not to depart from this simple rule. To adopt the entirely new concept proposed by the Treasury would appear similar to the action of a hunter who, lost in the swamps and having practically regained solid ground, turns his back on the clearing that appears before him to plunge back again deep into the swamp and get himself thoroughly lost in order that he might again seek to find his way to solid ground a second time.

The Treasury is trying to reduce our depletion allowance drastically. The brick and tile industry is a small industry in total dollar volume and is composed of several hundred small companies scattered all over the country. It is an industry which is subject to extreme fluctuation in volume and which generally operates on a small profit margin. It is an industry which has been hard hit by the decline in business activity. In 1957 the average annual business of each plant was less than $400,000 per year and the average reduction in tax per plant because of depletion was approximately $7,500 only.

We are told that the proposed legislation will result in largely increased revenue. Certainly the depletion allowed to the brick and tile industry does not hide these mammoth amounts. We have conducted a survey of the brick and tile industry. It might be of interest to the committee to know that after hearing the testimony of the Treasury, we conducted a telegraphic poll of every known company in the United States to determine exactly the amount of depletion credit that they received in 1957, which was the last available year. We have the responses from all but 20 of the companies in the United States and the figure that we are going to show you of $4,400,000 approximately—actually it was a few hundred dollars over that—is an actual and correct poll, one that we have not previously had and we do not believe had been previously accurately available.

This survey was to determine the reduction in taxes for the year 1957, due to the percentage depletion deduction. The total reduction for the entire industry, from the entire depletion allowance, was about $4,400,000 per year. Of this total, the Treasury's proposal would allow some percentage. Thus, the amount to be taken away from the brick and tile industry by the legislation is less than $4 million per year. This amount could not be detected on the fiscal budget of the United States with a 40-power eyeglass.

We sincerely feel that if the Congress should adopt the legislation proposed by the Treasury, unfair and unjust discrimination will result to our small group of independent businessmen. We are competing daily with those who produce sidings, walls, and structures of other buildings materials such as steel, aluminum, and gypsum. These competitive industries are denied no part of their present depletion by the Treasury's proposal, while our industry will be deprived of much the larger part of the depletion now allowed us. The sales of

any one of a number of individual companies in these competitive industries would exceed our total industry sales of brick and tile. The depletion deduction of any one of a number of these companies, which would not be affected by this proposal, would, we believe, greatly exceed the entire amount in controversy for the brick and tile industry.

It is significant to note that the cheerful acceptance of the Treasury's bill by certain other industries which have appeared, and they also accepted it—provided that it would be clarified so as not to affect them—is probably due to the fact that the processes specifically excluded in the case of brick and tile clay are just as specifically allowed to these industries.

For example, according to the proposal talc can be pulverized, but fine pulverization is excluded for brick and tile clay. Magnesite can be burned and quicksilver can be furnaced but thermal action is excluded as to brick and tile clay. Phosphate rock can be sintered and nodulized but brick and tile clay cannot be molded, shaped, calcined or otherwise treated by thermal action.

Our product is one of the basic and required materials in the construction industry for our growing economy and improved standards of living. Whereas years ago having a brick home was considered a measure of wealth, now ownership of a brick home is a must to reduce maintenance for the citizen who makes a down payment on a 25- or 30-year mortgage and expects to pay it off like rent and end up with a substantial equity. Brick is the favored material for church, institutional and commercial construction, where economy and long cost-free life are of maximum importance. Such a vital part of our construction industry should not be drastically discriminated against as the Treasury proposes.

Thank you.

The CHAIRMAN. Thank you, Mr. Boldrick.

Mr. Dunwody?

Mr. DUNWODY. My name is Kenneth W. Dunwody. I am president of the Cherokee Brick and Tile Co. of Macon, Ga. I am also currently the president of the Structural Clay Products Institute, the only association of the brick and tile industry. I greatly appreciate this opportunity to appear before you in opposition to the Treasury's proposed legislation which, if enacted, would deprive us of practically the entire depletion allowance which Congress gave us in 1951.

I would like to set forth briefly the history of our dispute with the Treasury concerning the interpretation of the present statute. I believe that the Treasury's attitude and tactics have amounted to persecution of my company and of the brick and tile industry in general.

On October 20, 1951, the President signed the Revenue Act of 1951 which granted a 5-percent depletion allowance to brick and tile clay. I am not a lawyer, but the statute clearly said this was to be computed on the selling price of our burnt brick and tile since burnt brick and tile are the first commercially marketable mineral products we obtain from our clay. Everyone in the industry knows, and the Treasury has agreed, that there is no commercial market for our clay until it is made into burnt brick and tile. However, the Treasury in November 1952 issued proposed regulations which, in effect, provided that we have to compute our depletion allowance by applying the 5-percent rate to a hypothetical value for clay before it enters the pugmill.

Our talks with representatives of the Treasury revealed that they contended that the pugmill and later processes are "manufacturing." They said you cannot include what they term "manufacturing" processes in figuring the depletion base.

I was amazed to see the Treasury take such a position. I immediately got in touch with Senator George and a Georgia Congressman who was then on the Ways and Means Committee, Mr. Sidney Camp, and told them of the Treasury's attitude. Senator George wrote me, "I think the regulation tends to defeat the real intent of the Congress." Mr. Camp also expressed to me the same view. Our attorneys advised me that the statute was clear and that the proposed regulation was patently invalid. Other members of the brick and tile industry shared my view of the statute and our industry protested the proposed regulations which the Treasury had issued. However, the final regulations issued in July 1953 by the Treasury took the same position as had the proposed regulations.

It then became clear that we would have to litigate to obtain the depletion allowance which Congress had given us. Consequently, in September 1953 my company filed suit in the District Court for the Middle District of Georgia for its fiscal period ending September 30, 1951. In June 1954 the district court upheld our contention and held that the 5-percent rate should be applied to the sale price of our burnt brick and tile, since these were the first commercially marketable mineral produce we obtained. The Government appealed this case and the Court of Appeals for the Fifth Circuit affirmed the district court's decision in January 1955. It held that the statute is "clear and unambiguous."

After the decision of the Court of Appeals for the Fifth Circuit, the Internal Revenue Service announced that it would not follow that decision. I again talked to Senator George about the matter, and on June 4, 1955, Senator George wrote to Mr. T. Coleman Andrews, then Commissioner of Internal Revenue, that—

> The statute defining mining for purposes of computing depletion allowance for Federal income and excess profits tax purposes does not exclude manufacturing processes so long as they are ordinary processes normally and necessarily used in obtaining commercially marketable mineral products.

The Senator further stated that, "The intent of Congress in this matter is too clear to admit of argument." Mr. Andrews, however, insisted on continuing the litigation.

In spite of the fact that the Cherokee Brick and Tile Co. had won its case in the court of appeals, the Government did not even then let my company have the allowance to which Congress and the court of appeals had said it was entitled. Cherokee was forced to file another suit in the district court for its fiscal years 1952, 1953, and 1954. The Government did not contend that the facts were any different in these years; it merely reargued the law in the district court, taking the same position as it had in the first case. The district court again held for Cherokee. This time the Government did not appeal.

At long last, I assumed that Cherokee's depletion controversy had finally been settled. However, I overlooked the extreme and arbitrary attitude of which the Treasury is capable. The Treasury still would not agree with the courts, and, consequently, Cherokee filed a third suit in the same district court, this time for the fiscal year 1955.

Again, the Government conceded that the facts were the same; again, the Government made the same discredited legal argument; again, the district court held for Cherokee. But this time the Government appealed our case to the Court of Appeals for the Fifth Circuit, along with 12 other cases, all of which had been decided in favor of the taxpayer by district courts. In these cases, the Government asked the fifth circuit to reconsider and overrule the original Cherokee decision. The court of appeals, however, upon reconsidering that decision, reaffirmed it.

On this round, the Government did not stop the court of appeals. It filed a petition for certiorari with the Supreme Court, even though the fifth circuit as well as three other courts of appeals had all adopted the same interpretation of the statute and had all agreed that the statute is "clear and unambiguous." In October 1957 the Supreme Court refused to review the question, denying the petition for certiorari which the Government had filed.

After the Supreme Court denied certiorari, the Government finally capitulated. Thus ended litigation on this point after a court fight which had lasted over 4 years and which involved great expense for Cherokee and other members of the small brick and tile industry.

The Treasury now seeks to have the statute amended so as to repeal the commercially marketable product rule and to adopt the discredited position it took in its regulations. I might point out that this is the third time the Treasury has made such an attempt. In 1954 the Treasury came to this committee and recommended a provision for the 1954 code which would accomplish the same result as to brick and tile clay as the current proposal. The Treasury represented to this committee that such amendment was in accord with the interpretation of existing law, although it knew full well that the first Cherokee case was to be argued in the district court a few days later. This committee did not adopt the suggested amendment.

Last year the Treasury again submitted a similar proposal as to brick and tile clay to this committee, but no action was taken. Thus, after the Treasury finally decided to bow to the unanimous decisions of the courts, it immediately came to Congress in order to try to have the law changed to embody its wishes. Now the Treasury comes back to you again and requests the same type of legislation.

Perhaps this action by the Treasury does not appear to you to be persecution. To me, as a layman, it seems that requiring a small company to go to the district court three times, to the court of appeals twice, and finally to the Supreme Court, is persecution. Furthermore, the Treasury litigated this question from coast to coast and lost more than 25 court cases involving producers of brick and tile. In this long litigation it did not win a single case. Not until 1957 did the Treasury finally end this fight as to brick and tile clay. It seems to me that this is persecution of a small industry. There should, I believe, be some means of protecting a citizen against this sort of treatment. Now that we have established our right to what the statute clearly gives us, and what Senator George and Congressman Camp, as well as all the courts, have said was clearly intended, the Treasury seeks to take it from us.

I earnestly request that this committee reject the Treasury's legislative proposal. After a long fight, we have established our position.

We have succeeded in having the statute interpreted, as Congress intended, so as to give us a simple, workable method of computing our depletion deduction. The Treasury not only seeks to reduce this allowance drastically but also to substitute a rule which is unworkable and purely arbitrary.

Even if our depletion allowance is too large, which the Treasury has not even attempted to show, any reduction in depletion allowance should be by a simple reduction in rate. Certainly, there is no need to impose on our industry an arbitrary and unworkable method of computation such as the Treasury has proposed.

I do not feel qualified myself to discuss the technical and legal aspects of this legislation. Mr. Frank Erwin, who will appear next, will discuss these matters. As a small brick and tile producer, I have merely tried to present to you a brief picture of the fight in which we have engaged in order to show the Treasury's unreasonable attitude and to ask that you end this persecution by rejecting the Treasury's proposal.

The CHAIRMAN. Thank you, Mr. Dunwody.

Mr. Erwin, you are recognized, sir.

Mr. ERWIN. Mr. Chairman and members of the committee, I am Frank Erwin, of Austin, Tex. I am here representing the Elgin-Butler Brick Co. and the Elgin Standard Brick Manufacturing Co. Although those two brick companies have similar names and are both located near Austin, Tex., they are separately owned and are aggressive competitors with each other.

I am a practicing attorney, but I am not a practicing lobbyist. This is the first time that I have ever appeared before any congressional or legislative committee and this is the first time that I have ever actively attempted to influence the course of any Federal or State legislation.

The reason for my being here on this occasion is that my law firm regularly represents the above-mentioned brick companies, and I handled a series of tax refund suits in which those two companies were finally able to force the Treasury Department to allow the clay depletion deduction that was approved by Congress in 1951.

We won those lawsuits in the trial court; we won them in the circuit court; and in the first of those suits we successfully opposed the Treasury's attempt to have the U.S. Supreme Court grant certiorari.

Since this is nothing more than a continuation of the Treasury's effort to have those and similar cases overruled, I deem it to be my duty to continue to defend my clients against the Treasury's repeated attempts to substitute its ideas about depletion for those heretofore approved by Congress.

We want to be completely forthright with the committee, and we want to meet the crucial issues head on, because we are convinced that if we can clear away the underbrush and show you exactly what the Treasury is trying to accomplish by this proposed legislation, you will reject it once and for all.

The hearings up to this point have made it abundantly clear that although this proposed legislation purports to adopt a new approach to the depletion allowance for all minerals, its primary intended effect is to drastically reduce the present depletion allowance for clay and only one or two others.

That fact has been demonstrated here time and again by the Treasury's quick assent to amendments suggested by industries that are inadvertently affected by the complicated and ill-conceived legislation that has been proposed by the Treasury Department. The fact that coal and sulfur and potash and all of the metallic minerals now have depletion allowances that are based on commercially marketable products and will continue to get their present depletion allowances regardless of whether or not the proposed legislation is adopted, fully explains why their representatives have here told you, although with varying degrees of enthusiasm, that they have no particular objection to the Treasury's proposal.

But even those witnesses have said that insofar as their minerals are concerned, they prefer the existing statute to the suggested amendment. Most of them have begun their statements by piously telling you that they approve of the proposed legislation in principle, but then they have proceeded to suggest a few so-called technical changes which, if adopted, would completely rewrite the bill insofar as their particular minerals are concerned. It's a simple case of "I don't care what you do to the other fellow so long as you leave me alone."

Just so there can be no mistake about it, I want to say here and now that the clay pit owners who make structural brick and tile do not approve of this proposed legislation either in principle or in any particular. They are unalterably opposed to it because it is grossly discriminatory against them and if adopted it will deprive them of fair and just compensation for the exhaustion of their capital asset, namely, clay.

It has already been conceded by the Treasury in this hearing that the primary purpose of any depletion allowance is to compensate the owner for the exhaustion of his mineral in place in the ground. Since that is true, the proper way to test whether or not a depletion allowance is excessive is to compare the dollar amount of the depletion allowance with a fair compensation to the mine owner for the portion of his mineral deposit that has been taken out of the ground and used up.

Any other test of the excessiveness of a depletion allowance is either foolishness or calculated deception. I do not care to impute deception to the Treasury Department, but I do not hesitate to say that all of this talk about the excessiveness of a depletion allowance being measured by mining processes or manufacturing processes or neutral processes (whatever those are) is sheer and unadulterated foolishness.

The Treasury contends that burnt brick and tile are manufactured products obtained by the application of manufacturing processes. From that contention the Treasury argues that to base a depletion allowance on the market price of burnt brick and tile is to allow depletion on manufacturing processes and on manufactured products. That argument evidences a complete lack of understanding of the fundamental theory of depletion.

Depletion is not allowed on any process, whether mining, manufacturing, or neutral, and it is not allowed on any product, whether manufactured or not. As stated above, depletion is allowed as compensation to the mineowner for the portion of his mineral deposit that he extracts from the ground and uses up.

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Percentage depletion is merely one of the methods that Congress has provided for determining the dollar amount of that depletion. Under the present law the depletion allowance is computed as a specified percentage of the value of the first commercially marketable product obtained from the mineral deposit, because Congress has felt that the value of the first salable product will furnish an easily ascertainable dollar base to which the specified rate can be applied.

Therefore, even if the first commercially marketable product is a manufactured product obtained by the application of manufacturing processes, that in no way means that the depletion is being allowed on that product or on any processes applied to obtain it. The depletion is allowed only on the depleted natural resource. The value of the first marketable product merely provides a readily ascertainable dollar base to which any rate fixed by Congress can be applied in order to allow any dollar amount of depletion that Congress determines to be fair and equitable.

The proper dollar amount of depletion is, and can be, readily controlled by Congress by simply adjusting the specified rates.

As I said before, it is foolish to talk about the excessiveness of a depletion allowance being measured by the adjective that is used to describe a process, whether that adjective is manufacturing, mining, or neutral. The proper way to test whether or not a depletion allowance is excessive is to compare the dollar amount of the depletion allowance with a fair compensation to the mineowner for the portion of his mineral deposit that has been taken out of the ground and used up.

At this point, I want to give you a concrete example of what the Treasury terms the "excessive" depletion allowance that clay pit owners are getting under the present law. But, instead of dealing in mere catch phrases and conclusions, I want you to see the present statutory depletion allowance in operation with actual facts and figures.

In the case of practically all of the owners of deposits of brick and tile clay, face brick is their big selling item. That is the brick primarily used in constructing houses, office buildings, schools, and similar structures, and it is the brick with which most of you are familiar.

In the making of face brick, it takes at least 2½ tons of clay to make 1,000 brick. In the United States today face brick sells at an average price of $35 per thousand. Thus, when a claypit owner takes 2½ tons of clay out of the ground and processes that clay into 1,000 face brick and then sells the 1,000 brick for $35, he is getting a gross price of $14 per ton of clay for the brick he sells.

That $14 per ton gross price is his depletion base under the present statute, because it is conceded by the Treasury that nowhere in the United States do clay miners have an opportunity to sell more than negligible quantities of their brick and tile clay unless, and until, they process that clay into burnt brick and tile. In other words, the burnt brick and tile is a claypit owner's first commercially marketable product.

The depletion rate for brick and tile clay is 5 percent, so under the present law the claypit owner is entitled to 5 percent of the selling price of his brick, which, in the case of face brick, is $14 per ton of clay. That means that under the present law a claypit owner gets a depletion allowance of 70 cents—5 percent of $14—for each ton of his brick and tile clay that is made into face brick.

That 70 cents per ton is the depletion allowance that the Treasury Department calls excessive. Gentlemen, good dirt is worth 70 cents per ton, and when it is remembered that the depletion allowance is supposed to compensate the mineowner fairly for the exhaustion of his capital asset, it is manifestly ridiculous to say that clay which can be made into brick and sold for $14 per ton, is not worth at least 70 cents per ton in place in the ground.

Perhaps this point can be made even clearer if we look at the situation in a slightly different way.

It is apparent that every mineral in place is increased in value by every process that is applied to it, including the process of extracting it from the ground. The only reason for allowing any value-increasing process to be applied before a depletion allowance is computed, is to get to a product that has an easily ascertainable value—namely, an established market price, because experience in this depletion area has shown that serious and insoluble problems arise in trying to establish a fictitious value for a product that has no market value.

This procedure of applying value-increasing processes—whether manufacturing, mining, or neutral—does not result in the dollar amount of the depletion allowance being excessive, because the dollar amount of the depletion allowance is controlled by Congress in the selection of an appropriate rate for each mineral after it has been determined what the first commercially marketable product for that particular mineral is.

Therefore, since the rationale for allowing the application of any value-giving process is to get to the easily ascertainable value of a commercially marketable product, the Treasury's proposal would destroy that whole rationale in instances where the proposal would cut off the processing before a commercially marketable product has been obtained.

If you are not going to allow sufficient processing to get to the easily ascertainable value of a commercially marketable product, there is no point whatever in allowing any processing at all—not even the process of extracting the mineral from the ground.

Let us look at two examples of the operation of the practice of allowing value-increasing processes to be applied before a depletion allowance is computed.

It is apparent that gold and silver ores are worth more after they have been dug out of the earth and hauled to the mine head than they are in place in the ground. It is likewise apparent that those gold and silver ores are worth more after they have been hauled to the mill than they are at the mine. It is equally apparent that the gold and silver ores are worth still more after they have been crushed, and doubtless the highly developed and extremely costly processes of concentration add greatly to their value.

But that tremendous increase in value due to the extraction and transporting and crushing and concentration of the gold and silver ores was taken into account when Congress set the 15 percent depletion rate for those minerals.

Stated somewhat differently, Congress determined that in the case of gold and silver ores 85 percent of the value of the commercially marketable products is attributable to the extraction and treatment processes and only 15 percent of the value of the commercially marketable products is allocated to compensate the mineowner for the

exhaustion of his ore deposit. We have no quarrel with that determination.

However, in like manner, Congress knew when it set the depletion rate for brick and tile clay that burnt brick and tile are the first commercially marketable products of that clay. That fact is clearly evidenced by a letter of June 4, 1955, which Senator Walter F. George wrote to Mr. T. Coleman Andrews, who was then Commissioner of Internal Revenue.

Senator George was chairman of the Senate Finance Committee at the time the depletion allowance for clay was written into the Internal Revenue Code in 1951, and on that point Senator George made the following statement in his letter to Commissioner Andrews:

> I personally recall the discussion in executive session between members of the Senate Finance Committee when this statute was under consideration. At the time it was not only understood but I pointed out what I knew and believed to be the facts about brick manufacture.
>
> Brick clay at this time has no commercially marketable value until it is baked or cooked. The Senate Finance Committee certainly understood this clearly before the act, giving depletion allowance to brick clay, was passed.
>
> The statute defining mining for purposes of computing depletion allowance for Federal income and excess profits tax purposes does not exclude manufacturing processes so long as they are ordinary processes normally and necessarily used in obtaining commercially marketable mineral products.

Unfortunately, I have no such statement from any member of this committee who was on the committee at the time this depletion bill was passed, but I am informed that a similar discussion was had at the time the depletion allowance was discussed by this committee.

Congress also knew when it set the depletion rate for brick and tile clay that the value of the clay in place in the ground is increased by digging the clay out of the ground, by crushing and screening the clay, by forming the clay into the desired shape and size, and by burning the clay in a kiln to obtain the brick.

It is true that the treatment processes applied to clay are crude and elemental when compared to the extremely complicated chemical and thermal processes of concentration freely allowed by the Treasury in the case of many of the metallic minerals, but obviously the extraction of the clay and its processing into brick and tile does substantially increase its value.

However, Congress determined that in the case of brick and tile clay 95 percent—I repeat, 95 percent—of the value of the burnt brick and tile is attributable to the extraction and treatment processes, and only 5 percent—I repeat, only 5 percent—of the value of the burnt brick and tile is allocated to compensate the mineowner for the exhaustion of his clay deposit.

We earnestly submit that since brick and tile is composed of nothing but clay, and since the extraction and treatment processes required to product brick and tile are simple and few in number, it seems perfectly clear that when only 5 percent of the value of the brick is allocated to compensate the claypit owner for the raw material out of which the brick is made, it is certainly a conservative allocation.

It will not be regarded as "excessive" by anyone who makes any objective study of the situation.

We believe that the foregoing comments demonstrate the complete inaccuracy of the Treasury's allegation that claypit owners are receiving an "excessive" depletion allowance under the present statute.

However, we also want to spell out additional reasons why the concept of "the first commercially marketable product" should be retained in the law.

Laying aside for the moment such additional depletion allowance as Congress may feel is justified in order to furnish incentive to mineowners to search for new supplies of raw material, it has been stated many times in these hearings that a mineowner is entitled to a depletion allowance that is sufficient to compensate him fairly for the exhaustion of his mineral deposit. Therefore, if we could determine the value of that mineral in place, the job of computing a correct depletion allowance would be a great deal simplified.

However, the problem of placing a value on a mineral in place in the ground presents extreme difficulties, because there is no objectively determined price—in other words, no market price—for a mineral in place. The difficulty inherent in trying to value minerals in place was responsible for the abandonment of discovery depletion and the adoption of percentage depletion.

By percentage depletion Congress adopted what it intended to be an easily computable allowance that avoids the difficulty of attempting to value minerals in place, but percentage depletion furnishes an easily computable allowance if, and only if, the applicable rate is to be applied to an objectively determined price.

The presence of an objectively determined price—that is, a market price determined by sales between willing buyers and willing sellers in a competitive market—is the very cornerstone of percentage depletion. Any effort to establish the depletion base at some cutoff point at which the product has no market value will bring a return of all the difficulties and confusion that were inherent in discovery depletion.

The Treasury would permit you to believe that once a definite cutoff point is written into the law, most, if not all, of the problems and difficulties in this depletion area will thereby be solved. Nothing could be further from the truth.

Gentlemen, if I make only one point to you, this is the one I want to make—setting a definite cutoff point for a mineral at a place where there is no market value will compound confusion, arguments, and litigation. That fact has been recognized ever since percentage depletion has been in the law.

I think it is appropriate to recall that the legislative history of this statute shows that it was the repeated attempts by the Treasury Department to establish cutoff points before marketable products were reached that caused Congress to write the present "commercially marketable product" provision into the law in 1943.

At that time the Treasury was contending that the furnacing of quicksilver ore and the cyanidation of gold were not allowable processes even though they admittedly were required in order to reach commercially marketable products. Accordingly, in 1943 Congress not only expressly provided that the cyanidation of gold and the furnacing of quicksilver ore shall be allowed, but also wrote into the law in clear and unmistakable language that in the case of all minerals and ores the percentage depletion allowance shall be based on the value of the commercially marketable product. The courts have uniformly interpreted that statutory language to mean the first commercially marketable product that the mineowner obtains from his mineral or ore.

I want to emphasize that the court decisions have held that the controlling factor is the first commercially marketable product that a mineowner obtains from his mineral deposit and not the first commercially marketable product that he sells. Thus, if a mineowner elects not to sell his product until he has processed it beyond a stage at which he could have sold it, under the existing court decisions his depletion allowance is limited to the market value of the product that he could have sold and is not computed on the value of the product that he did sell.

Therefore, all of this talk by the Treasury about the danger of the present statute permitting depletion allowances to be based upon the market value of steel girders, processed gasoline, and completed automobiles is surprisingly irresponsible and is wholly without foundation in the decided cases.

In the Senate report that accompanied the 1943 amendment containing "the commercially marketable product" provision, it was stated that

> The purpose of this provision is to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product shall be considered as a part of the mining operation.
>
> The law has given rise to numerous disputes. The definition here prescribed expresses the congressional intent of these provisions as first included in the law. It is therefore made retroactive to the date of such original provisions.

However, despite the plain provisions of the statute and the clearly expressed congressional intent, the Treasury thereafter tried to disallow the pulverization of talc, the burning of magnesite, and the sintering and nodulizing of phosphate rock, even though those processes were required in order to obtain commercially marketable products from those minerals. In each of those three cases Congress amended the law to specifically allow those processes.

Thus, so far as we can discover from a careful study of the legislative history of this statute, in every single instance where the Treasury has tried to disallow processes before a commercially marketable product has been obtained, Congress has invariably amended the law to assure that the mineowner can base his depletion allowance on the first commercially marketable product that he can obtain from his mineral deposit.

We respectfully urge that there is no valid reason why clay-pit owners should not also be allowed to continue to base their depletion allowance on the first commercially marketable product that they obtain from their mineral deposit.

The reason why Congress has always insisted on percentage depletion being based on an established market price is perfectly plain. It is to eliminate uncertainty in the law and to assure that Congress, rather than the Treasury Department, will determine the amount of depletion that will be allowed. Let us look at some of the alternatives to basing percentage depletion on an established market value.

During the course of these hearings the Treasury has suggested that where the processes allowed under its proposed legislation do not result in a marketable product, the Treasury will use a so-called "proportionate profits formula" to obtain a value upon which to base the depletion allowance. That may sound like a simple and effective solution to the problem, but listen to what Mr. Donald H. McLaughlin, the then spokesman for the American Mining Congress, told the Senate Finance Committee about the "proportionate profits formula"

in the 1943 hearings that led to the enactment of "the commercially marketable product" provision:

> The question of allotment of profits to specific processes—

and that is the proportionate profits formula—

> was discussed at the conferences (held between Assistant Secretary of the Treasury Douglas and others of the Treasury Department and representatives of the mining industry) in 1932, but it was ruled out on account of the difficulties of administering it in a simple and equitable way not subject to controversy.
>
> In spite of those considerations that were regarded as compelling in 1932, provision for allotment of a portion of the profits to processes subsequent to those mentioned was made in the regulations issued in 1940 and applied in the claims for deficiencies—then under discussion.
>
> As a result, the differences in treatment of taxpayers, even in the same type of mining operations, have been so great and inequitable that the wisdom of the early decision to keep the administration of the law on as simple a basis as possible has been confirmed in a most positive way.

I would like to interpose at this point that you gentlemen may wonder why the American Mining Congress would take that position in 1943 and tell you that they approve this proposed legislation in principle now. The answer is that by legislation and otherwise they have now gotten approved all of the processes they need to get their minerals to a commercially marketable product.

Mr. McLaughlin's comments about the unsatisfactory results produced by the "proportionate profits formula" are as true today as when they were made in 1943. Use of the formula will result in great and inequitable differences in the dollar amount of depletion allowed taxpayers who are similarly situated in all respects that ought to be controlling.

I know personally of the inequities and ridiculous results that flow from the use of this formula. In the case of the two brick companies that I represent here, the examining revenue agents, using the same cutoff point for both companies and using the proportionate profits formula, proposed to allow one company 50 cents per ton less depletion for its clay than they did the other.

Assuming that the companies each mined 50,000 tons of clay per year—which figure is approximately correct—that meant that under the proportionate profits formula one company would have received $25,000 a year more depletion than the other on the same amount of clay. That was true even though both companies mined the same type and grade of clay from pits not over a half mile apart and both made the same type of brick and tile out of the clay.

The basic fallacy of the proportionate profits formula is that it operates entirely on the direct costs of the processes that are applied to the mineral in place in the ground and makes no allocation or allowance whatever for the value of the mineral itself.

In the first Cherokee case, in commenting on the proportionate profits formula, the trial judge said that gross income computed upon that formula "is obviously a pure fiction which might be false more often than true."

But the Treasury is ingenious in this field of establishing a fictitious value or a product that has no established market value. In the proposed 1954 regulations that were issued on November 3, 1956—but which are still not yet adopted even though more than 2 years have now elapsed since they were proposed—the Treasury abandoned the

proportionate profits formula, and suggested three other methods for guessing at the value of a product that has no market value.

I have set out here in detail and verbatim the provisions that are in those regulations, but I want to tell you in plain words what these things say and you can read them and see if I misrepresent them in any particular. First, they say that if the cutoff point product, that is, the product that you have at the cutoff point that the Treasury wants to establish, has no commercially marketable value, then the Treasury will determine the price at which that product would be sold if anybody would buy it.

They say they will reach that result in one of three ways. They reserve to themselves a choice as to how they are going to get to that result. First, they say they are going to base this value on the sales of similar products, whatever they are, that are produced in the same area as the taxpayer, and then they are going to make proper adjustments for material differences in the taxpayer's products and these so-called similar products.

There isn't any legislative standard of any kind or any other kind of standard in that kind of a proposition. It lets the Treasury do whatever they want to do. That is their first method of getting at this fictitious price.

The second method they propose to allow themselves is that they are going to base this fictitious price on the selling price of similar material, whatever that is, in different areas from where the taxpayer is. That means they can go anywhere in the United States and find a product that they say is similar and use that as a base; but they are not satisfied with that.

There, too, they allow themselves the right to make proper adjustments for material differences, whatever they are, but that is not all. They still give themselves a third way to get at this fictitious price. They are going to base it on the taxpayer's actual cost of getting the product, plus what they call a rate of profit determined to be appropriate.

They are going to determine what kind of appropriate profit the taxpayer ought to have, and they are going to use one of three methods for finding what that appropriate profit is.

First, they are going to compare it with the rate of profit realized on sales of similar products, and they don't even limit that as to whether it is in the taxpayer's area or some other area; or they are going to compare it with the rate of profit that the taxpayer realizes on the sales of his own product; or, thirdly, they are going to base it on a comparison with a rate of profit ascertained by "any other appropriate method."

Even a casual reading of those proposed regulations—and I have not made them up, but the Treasury has them written down in the proposed regulations under the 1954 code. Even a casual reading of those proposed regulations demonstrates clearly that confusion and uncertainty will be compounded and there will be an endless course of litigation if the Treasury is given such unbridled discretion in the determination of the value to be assigned to a cutoff point product that has no market value.

Yet those Alice in Wonderland regulations—and I don't think they can be called anything else—may well achieve the force of law if

Congress adopts the legislation here recommended by the Treasury Department.

I was astonished during the Treasury's presentation on March 5 to hear it suggested in this committee room that the Treasury should have great discretion in the determination of such values so as to give greater "flexibility" to the law. I was equally surprised to hear it suggested that where the cutoff point product has no market value, the taxpayer has some power to choose the method to be used in putting a value on that product for depletion purposes.

I earnestly hope that you gentlemen have not been so long and so far removed from the activities of Internal Revenue agents that you believe either that the taxpayer has any power to choose the method to be used or that the revenue agents in the field approach their audits in the spirit of sweet reasonableness which marked Mr. Lindsay's appearance here last week.

On the contrary, for 4 years I have been representing the owners of mineral deposits in their disputes with the Treasury over depletion allowances, and I give you my word that I have yet to meet a single revenue agent who does not adopt and apply whatever method of computing value he can think of that produces the lowest possible depletion allowance.

Our only relief has been an appeal to the courts, and after years of effort and at great expense we have only recently succeeded in freeing ourselves from the arbitrary and capricious decisions of the Internal Revenue Service in this area.

The commercially marketable product rule as now interpreted by our Federal courts has at last brought certainty and definiteness to this depletion area where they did not previously exist. I beg you—and I use that word in its literal meaning—I beg you not to abandon the commercially marketable product provision in the present law and put the clay pit owners back on the tender mercies of the Treasury's revenue agents insofar as their depletion allowances are concerned.

The many witnesses that have preceded me in this hearing have told you in effect that if you adopt the checkoff list approach to depletion suggested in the Treasury's proposed legislation in order to establish cutoff points that will be free from doubt and uncertainty it will be necessary for you to list separately the particular processes employed in the case of virtually every mineral or ore that receives a depletion allowance. It would be next to impossible to compile such a list without discriminating between minerals, and once compiled the list would have to be frequently amended and revised.

However, as we have tried to demonstrate in this statement, and as I emphasized to you a while ago, even if you succeed in establishing a definite cutoff point for each mineral and ore, whenever such a cutoff point does not result in a commercially marketable product, confusion, disputes, and litigation will only be increased, because the attempt to establish a fictitious value for a product that has no established market value presents serious problems that neither the Treasury Department nor the taxpayers have ever been able to solve.

Certainly the Treasury's proposed legislation does nothing to solve those problems; it doesn't even talk about them.

Earlier in this statement we made the point that it is not necessary for Congress to abandon the clear and definite standard of the first

commercially marketable product in order to assure the proper dollar amount of depletion for each mineral. Any excessive depletion allowance can be readily corrected by the simple expedient of reducing the applicable rate.

We sincerely believe that the dollar amount of depletion that is presently allowed clay pit owners is not excessive and constitutes nothing more than fair compensation to the clay pit owner for the exhaustion of his natural resource that is being exhausted.

However, we know that there are those, particularly some members of the Treasury staff, who disagree with us. We understand that there are others who believe that certain other minerals are receiving either too much or too little depletion.

Therefore it seems to us that the entire area of percentage depletion needs to be studied carefully by one or more advisory groups such as those that have recently assisted you in other areas of the Internal Revenue Code. If, after you have received the benefit of such information and recommendations as you may care to obtain, you conclude that clay is receiving an excessive depletion allowance, then we respectfully urge that you leave untouched the existing commercially marketable product provision. In that way the clay pit owners can know exactly what depletion allowance they are entitled to have, and they can receive that allowance without continuous disputes and litigation with the Treasury Department.

This concludes the statements on behalf of the structural clay products industry. We are indeed grateful for this opportunity to present our views to you, and we shall be glad to try to answer any questions that you gentlemen may wish to ask.

The CHAIRMAN. Gentlemen, I want to congratulate you and our colleague, Mr. Vinson, of Georgia, on the very fine statements which you have made to the committee this morning representing your views of what the committee should do with respect to this matter.

I might say this, Mr. Erwin: That had you not confessed to this being your first appearance before a congressional committee, I am sure the other members will join me in saying that we would have assumed that you were an old hand at this job.

Mr. ERWIN. Thank you, Mr. Chairman.

The CHAIRMAN. You have been very forceful in your statement and, I am sure, with many members of the committee very convincing in the points that you have made. All of you are to be congratulated on these fine statements.

Mr. ERWIN. Thank you.

The CHAIRMAN. Are there any questions?

Mr. MASON. Mr. Chairman?

The CHAIRMAN. Mr. Mason.

Mr. MASON. Mr. Erwin, I only want to make a comment or two. First, they raise giants in Texas mentally as well as physically, and perhaps financially too, but the second observation is this: In my opinion you three men, plus the testimony of Mr. Vinson, have placed the last nail in the coffin of that proposed scientific formula that the Treasury wants us to adopt as a basis for depletion allowance, instead of the commercial marketable value, which is a definite thing and can be arrived at definitely.

So far as I am concerned that proposal is dead.

Mr. ERWIN. Thank you, Mr. Mason.

The CHAIRMAN. Are there any further questions?

Mr. Baker will inquire, gentlemen.

Mr. BAKER. I joint the chairman and Mr. Mason in congratulating you gentlemen on not only comprehensive statements, but fine presentations.

Let us turn to section 613. Drop down to subsection (b)(3), 15 percent ball clay and so forth. Then drop down to brick and tile clay. Do you have it?

Mr. ERWIN. Yes, I am familiar with what you are talking about.

Mr. BAKER. Five percent on brick and tile clay, gravel, mollusk shells, and so forth, and 15 percent on all other minerals, including not limited to, and so forth, and it drops down to fire clay.

Mr. ERWIN. Yes, sir.

Mr. BAKER. Granite, limestone, and so forth. As I read the code, the brick and tile industry and certainly if we include pottery in that, although I don't know whether we include pottery or not, has 3 percentages in the whole industry, 15, 5, and 15. Is that right?

Mr. ERWIN. So far as the people for whom we speak, the structural and brick tile people, we have only two. They have 5 for brick and tile clay and 15 percent for refractory and fire clay.

Mr. BAKER. Ball clay doesn't affect you?

Mr. ERWIN. It is my understanding it does not.

Mr. BAKER. If there is any difference between you gentlemen on that point I would like to know it.

Mr. ERWIN. I would like to confer.

Mr. DUNWODY. There is no difference.

Mr. BAKER. Ball clay is used for what?

Mr. DUNWODY. I think it is used more in chinaware.

Mr. BAKER. Of course it has a higher commercial value ordinarily than brick, substantially so?

Mr. DUNWODY. Yes.

Mr. ERWIN. Brick and tile clay; yes, sir. That is our understanding of it, although we are not experts on that particular mineral.

Mr. BAKER. Incidentally, the Department of Agriculture says that 60 percent of all the ball clay in the entire Nation comes from where I come from. That is east Tennessee.

Mr. ERWIN. I believe that is true.

Mr. BAKER. We have a brick and tile, too. To show you that Congress must have known a little something about what they were doing prior to this time, the last sentence at the end of subsection (b) to my mind is illuminating. That is at the end of the 15 percent section which includes fire clay, limestone, bauxite, and what not. It says:

> The percentage shall be 5 percent for any such other mineral when used, or sold for use, by the mineowner or operator as riprap ballast, road material, rubble, concrete aggregates, or for similar purposes.

Does that, Mr. Erwin, apply to each of those preceding sections, or just to that one 15 percent section?

Mr. ERWIN. My understanding is it applies to the 15 percent, Mr. Baker. I am not looking at that statute right now.

Mr. BAKER. That is the only classification you could use for ballast, road material, and riprap.

Mr. ERWIN. Of course those three uses apply primarily to rock and not to clay, either limestone or some other type of rock, and not to

clay. I don't believe you would use clay for ballast, riprap and that sort of thing.

Mr. BAKER. Of course you would apply it to limestone.

Mr. ERWIN. It would apply to limestone; yes, sir.

Mr. BAKER. One of the fundamental arguments made here that concerned me for a while, and I have about gotten over my concern, is that some of these minerals in place in the ground have no commercial value as such. I understand that to be an argument of the cement and of the brick and tile people, as distinguished from the overall argument that many people were making that if you could measure it all in the ground, that would be the yardstick and we would start with that, but I believe each of you gentlemen stated that can't be done for various reasons.

Mr. ERWIN. Yes, sir.

Mr. BAKER. The thing that has been concerning me, and, as I say I am about over the concern, is if, for instance, cement rock or brick and tile clay or fire clay have no ascertainable commercial value in place, then where are you going to start?

The answer would be you would have to either take the Treasury's proposal, go to the end and work backward, put allocable costs and profits back to find out what it was worth to you, or else take the first commercially marketable product. I am right on that, am I not? You would have to do one of the two. It just seems like present law is certainly much clearer, much more ascertainable, and much easier to follow than to go back to the top and work back, and back, and back, and back.

Mr. ERWIN. We certainly agree with you, Mr. Baker.

Mr. BAKER. The cement problem really concerns me more than the brick and tile problem. I have never heard anybody could sell the clay on the market like you can sell raw coal. That is not done in this country.

Mr. ERWIN. We have proved it in a number of cases and it is now conceded by the Treasury Department that there is no opportunity for the claypit owners to sell brick and tile clay before they put it in the form of burnt brick and tile.

Mr. BAKER. Of course it is unanswerable. As Mr. Vinson said, you certainly can't sell the mud. That didn't convince me as much as it did Mr. Vinson, because I go a step further, that the mineral in place, and I know you follow me, apparently as to cement, the so-called cement rock as such, does not have an ascertainable value.

That is what burdens me a lot. Maybe there is something to the Treasury proposal that you would have to start at the top and work on back to find out what you can allocate to that cement rock if you are going to apply the "in place" rule, is there any place in the brick and tile industry that there is an ascertainable value before, let's say, the brick and the tile gets ready for the market in a salable form? Your answer to that apparently is no.

You take the clay out of the ground. You remove vegetable matters and whatever waste there might be, and then you come into a process, but you burn it.

Is there a cutoff point in the position of your industry at which there is a commercially ascertainable value before you obtain a brick, not necessarily the highest priced brick?

Mr. ERWIN. No, sir; there is not.

Mr. BAKER. I was intrigued by what you said a while ago, that it is not necessarily the highest quality product where you would arrive at the first commercially salable product.

Mr. ERWIN. May I give you an example of a court case?

Mr. BAKER. I think that would be helpful.

Mr. ERWIN. All right, sir. In the case of the Riverton Lime Co. down in Mr. Harrison's State, they have a deposit of a material which makes a particular kind of lime called hydraulic lime, and I am not enough of an engineer to know why hydraulic lime is important, but I understand that it is, particularly in making lime mortar.

Riverton took its rock and made hydraulic lime out of it, but that lime could be greatly improved in quality by the addition of some things to it, and then used for lime mortar. They sold very little of their hydraulic lime as such and the great portion of their production was sold in the form of this lime mortar after they had done something else to it, but the court said that because they could have sold their product in the form of hydrated lime, their depletion must be based on that value and not the value of the more expensive product where they went further and processed and sold.

Does that answer your question?

Mr. BAKER. However, let us correlate that to brick now. Certainly we know that there is different priced brick based on quality?

Mr. ERWIN. Yes, sir.

Mr. BAKER. Where would it be on brick, that is, where, if you make a fair interpretation of existing law, would be the cutoff point?

Mr. ERWIN. If we took our bricks and did not sell them at that point, but painted them or added some additional process to them and sold those additionally processed bricks at a higher price, then in my opinion the decided cases would require that we base our depletion on the first brick that we obtained before we added any of these additional processes to them.

Does that answer your question?

Mr. BAKER. Yes. Has that been held in the courts?

Mr. ERWIN. So far as I know, nobody has ever claimed that they were entitled to any greater depletion than the first brick that they were able to sell.

Mr. BAKER. Of course, as the brick comes out of the kiln and you use it as a brick for an inexpensive home, that would have a somewhat lower commercial value than one where they scratch it and add color to. What do they call scratching, which makes it much more attractive? Face brick?

Mr. ERWIN. Mr. Baker, this is a complicated subject and I will be glad to discuss it with you, but I would like to suggest that you can't compare the selling prices of a thousand tile or a thousand special kind of brick products necessarily with a thousand ordinary brick for the reason that you have to see whether or not they are being given the same depletion.

You have to see how many tons of material is used to make a thousand of each of the kinds of products. For instance, it takes twice as much clay to make a thousand tile as it does to make a thousand brick. It takes more than four tons of clay to make a thousand tile. It takes two tons of clay to make a thousand brick.

If you just looked at the selling price of a thousand tile, it would be approximately twice what a thousand brick would be. You might

think they are getting a lot bigger depletion on that tile because the selling price is twice as great, but it takes twice as much clay, so you come out about the same place.

Mr. BAKER. Does fire clay produce a higher-priced brick than what you refer to as brick and tile clay, which is in the 5 percent bracket?

Mr. ERWIN. Refractory brick brings a much higher price. If you take fire clay and put it into the form of face brick, it will command a somewhat higher price than face brick made out of brick and tile clay, but not much.

On that point, may I say a word or two about this first part of the Treasury proposal which I didn't discuss in my comments, because I just ran out of time, but this first section of the Treasury's proposal, in my opinion, is just as unfair and improper as it can be.

Fire clay is very much more valuable than brick and tile clay.

Mr. BAKER. If I may interrupt, I presume it is more scarce and harder to find.

Mr. ERWIN. That is correct; much more scarce. The thing about this, Mr. Baker, is you can't ship any kind of clay very far because it is heavy, very expensive to ship, and you can't compete, so what it really does is divide the regions of the United States into competing marketable areas or market areas, because you can't ship clay from Ohio to Texas and compete, nor vice versa.

In our area there is very little fire clay and it is very valuable when you have it. There is nothing in what is labeled (a), almost all the first page of the Treasury's proposal, except to cut the guts out of the fire clay depletion allowance. In plain language that is all in the world it does, and they have spent all of this complicated conversation doing one simple thing.

They say that if you use fire clay for anything other than to make refractory products out of it, you are going to get only 5 percent, and if you make refractory products you are going to get 15 percent. It seems to me, if there is anything at all to the depletion theory, that when you deplete a ton of fire clay it doesn't make any difference what you use it for.

Your natural resource is depleted and you ought to get the same depletion allowance whether you use it to make refractory products, or face brick, or tile, or sewer pipe, or whatever.

I think it is ridiculous to say that the amount of depletion you get is dependent upon the use that you put that fire clay to, because you have exhausted your deposit no matter what you do with it, and I just think the first section of this thing is so ridiculous that I didn't spend any time on it.

Mr. BAKER. To give you one illustration, there are at least some deposits where fire clay appears with coal above it and below it sometimes. If it comes very close, it is very expensive for people to get rid of that fire clay. Instead of it being of value in place it is expensive to get it out of there and see that it doesn't mix with the coal.

If it does they have to separate it.

Mr. ERWIN. Yes, sir.

Mr. BAKER. Instead of that fire clay having a value in that place to the prime product, coal, it takes a lot of bother to get rid of that thing.

Mr. ERWIN. The subject we are getting into now is also difficult and complicated, but I would suggest to you, sir, that this depletion

allowance ought to be based on the value of the particular deposit that it is being applied to.

It is true that in some areas of your part of the country fire clay has not much value for the reasons you have indicated, plus the fact that it is very plentiful and therefore when a man uses up a ton of his fire clay in your area he has not suffered any great loss for which he ought to be compensated.

Mr. BAKER. It is expensive getting the coal out, either by stripping or underground mining in order to get rid of the fire clay.

Mr. ERWIN. On the other hand, in my section of the country fire clay is scarce and very valuable, and I think when he exhausts a ton of his fire clay he ought to be compensated for it, and the fact that he gets more depletion than the man in Ohio who is trying to get to his coal doesn't offend me at all, because it is a whole lot more valuable in Texas than it is in Ohio.

Mr. BAKER. If we went into this whole subject of depletion, as I think we should, then is it your idea that each mineral product should be studied ratewise as to what that particular product is worth in place for the purpose for which it is being used?

Mr. ERWIN. No, sir; I do not think that. I would prefer to speak individually, if I may. I don't know how many of my friends agree with me, but my own idea is that it should be studied on the basis of what the material is worth under the particular circumstances or conditions in the area where it is, for the reasons I just indicated. You are going to get a different depletion allowance in dollars between the fire clay in your area and the fire clay in other areas where the fire clay is very expensive, and very rare, and very valuable, but that is not wrong, because a fire clay deposit in these other areas is a whole lot more valuable to the owners than a fire clay deposit in your area.

Do I make my point clear?

Mr. BAKER. Yes, sir. I think we are thinking along the same lines. You can't establish a nationwide percentage of rate for a particular mineral product where at some places it is not only valueless, but is a problem to get rid of this.

Mr. ERWIN. No, sir; I disagree with you. I think you can set a percentage rate and I think that because, for instance, they may sell clay in clay form to get rid of it, the difference in the computation of the depletion allowance will compensate for the difference in value that that clay has in one place and the difference in the other.

No, sir; it is my considered judgment that if Congress will stay with the first commercially marketable product and make whatever adjustments in rates they think are proper, you will get an equitable treatment in all areas.

Mr. BAKER. The first commercial product, as to that particular use?

Mr. ERWIN. I am trying to avoid the word "use" because of the impropriety with which I regard the early part of this proposal. I'd say just what is the first commercially marketable product that that particular taxpayer has in that particular area, because that is what he can first sell his product for.

Mr. BAKER. That answers it. You would put it on the particular taxpayer just as the Treasury would, but by an entirely different approach?

Mr. ERWIN. Yes, sir.

Mr. BAKER. Thank you.

That is all.

The CHAIRMAN. Are there any further questions?

Mr. ALGER. Mr. Chairman.

The CHAIRMAN. Mr. Alger.

Mr. ALGER. If no one else is going to say it, Mr. Erwin, taking all three of these statements together it strikes me that that is something of an indictment of the Treasury, and I for one feel an accounting should be made by someone to explain to the committee the facts in this case. On page 5 of Mr. Dunwody's statement the Treasury is, in effect, accused of falsifying before a congressional committee, if I understand the import of the testimony.

I don't want to be unduly harsh, but I have listened carefully to what the witness has said, and after litigating in these courts, court after court after court, and being defeated time after time, it strikes me that we deserve an accounting from the Treasury people.

My question, though, is with respect to another matter here. It is this: Have you any idea what the cost of litigation is because of this Treasury activity to, No. 1, the Cherokee Co., No. 2, to the brick and tile industry, and No. 3, do you think we can compute in any way the Government cost of litigating the particular claims in the attempt to recover revenue from the brick and tile industry in these cases in which the Government has been defeated over and over?

Mr. ERWIN. Mr. Alger, you know a lawyer never likes to talk about his fee. I can say in my case that they paid me a whole lot of money. I will ask Mr. Dunwody if he knows what his experiences were.

Mr. DUNWODY. I am sorry, but I really couldn't tell you, Mr. Alger. It has been more than we wanted. We have been in the court so many times that I have honestly forgotten what the figure was. I didn't try to keep up with it; it was too much.

Mr. ERWIN. I think that the total cost of litigation on behalf of these brick companies, and truthfully they are small independent companies, has been in terms of hundreds of thousands of dollars.

Mr. ALGER. Mr. Chairman, I don't want to pursue this, but I did want this to appear in the record. I intend to look further into it, and I would defer also to the judgment of my colleagues on this committee. I am impressed with the fact that it would be interesting as a part of these hearings to know approximately what the cost has been to the brick and tile industry. I would also like to ask the Treasury what they estimate the cost has been to the Federal Government in continuing to prosecute this attempted recovery of revenue from your industry.

Mr. ERWIN. That would be a sizable figure on both sides of the litigation.

Mr. BAKER. Could I ask one more question?

The CHAIRMAN. Mr. Baker.

Mr. BAKER. This is right along with Mr. Alger's line of inquiry, and I served on the Subcommittee on Internal Revenue Taxation 3 or 4 years. In this failure to acquiesce it seems to me the most glaring instance I have seen is this No. 2 Cherokee case. That is the one I want to ask about. They had the case in the district court. They went into the Fifth Circuit Court of Appeals, as I understand it.

That is all right. Let us say they maybe shouldn't acquiesce at that point, but should pursue it further, although there have been no contrary decisions.

To go back, you bring another suit in the district court and they did not appeal. As I gathered, and I am sure I understood Mr. Dunwody correctly, they just simply didn't appeal the decision of the district court, although the facts were the same.

Mr. ERWIN. That is correct.

Mr. BAKER. By all the rules of law and reason I would think the Government, being a party under the law, is bound by that decision. Did they give any reasons? When you undertook to claim the benefits of your district court decision in case No. 2, what did they do? Just say to you they weren't going to pay any attention to it?

Mr. DUNWODY. Mr. Andrews just stated they were not going to recognize the case and we were going to have to sue every year.

Mr. BAKER. Why didn't he appeal?

Mr. DUNWODY. I cannot answer why he didn't appeal.

Mr. BAKER. I don't mean why he didn't appeal. Mr. Erwin, that was the final decision, whether right or wrong, wasn't it?

Mr. ERWIN. Mr. Baker, I think one thing could be said. We would have had a lot more cases appealed if the fifth circuit hadn't told the Government not to bring any more of those cases down there unless they could get somebody to tell them they were wrong.

Mr. BAKER. That is all.

The CHAIRMAN. Again we thank you, gentlemen, for your appearance and the information that you have given the committee. It has been most helpful.

Mr. Forand.

Mr. FORAND. Mr. Chairman, I ask unanimous consent that there be inserted at the appropriate place in the record a telegram I received from Castellucci & Son, Inc., relative to natural stone.

The CHAIRMAN. Without objection that will appear in the record.

(The telegram referred to follows:)

PROVIDENCE, R.I., *March 6, 1959.*

Congressman AIME J. FORAND,
House Office Building, Washington, D.C.:

We are strongly opposed to current Treasury attempt to alter depletion allowance afforded natural stone industry. Treasury proposal is ambiguous and unworkable as applied to this industry.

CASTELLUCCI & SON, INC.,
JOS. CASTELLUCCI.

Mr. HARRISON. Mr. Chairman, I make the same request with relevance to various telegrams I have received.

The Chairman. Without objection, they will appear in the record.

(The telegrams referred to follow:)

WINCHESTER, VA., *March 11, 1959.*

Hon. BURR P. HARRISON,
House of Representatives, Washington, D.C.:

As an operator of high calcium limestone quarry in your district we sincerely hope that you will oppose the bill proposed by the Treasury Department designed to reduce or terminate depletion allowances to our industry.

SHENANDOAH VALLEY LIME & STONE CORP.,
WAYNE A. WHITHAM, *Treasurer.*

38410—59——19

STEPHENS CITY, VA., *March 11, 1959.*

Hon. BURR P. HARRISON,
House of Representative, Washington, D.C.:

As operator of a high calcium limestone quarry in your district we ask you to oppose proposed cutoff point in Treasury Department bill for percentage depletion. Fine grinding of chemical grade limestone is necessary to make agricultural limestone.

M. J. GROVE LIMESTONE CO.
CHARLES E. BASS.

ROANOKE, VA., *March 9, 1959.*

Representative BURR P. HARRISON,
Washington, D.C.:

Our company is deeply concerned with the outcome of the percentage depletion hearings now before the ways and means committee. We use in excess of 150,000 tons of raw shale annually in the manufacture of lightweight aggregate and elimination of the 5 percent depletion allowance would place extreme hardships on our existing operation and future expansion. We need your support to retain the depletion allowances as set forth in our present tax laws.

VIRGINIA LIGHTWEIGHT AGGREGATE CORP.,
E. K. POWERS, *Vice President.*

Mr. BAKER. Mr. Chairman, I make the request that a brief statement in respect to a byproduct of a copper company be inserted in the record.

The CHAIRMAN. Without objection that statement will appear in the record.

(The above-mentioned statement follows:)

STATEMENT OF E. H. WESTLAKE, CHAIRMAN OF THE BOARD AND PRESIDENT OF TENNESSEE CORP.

Mr. Chairman and members of the committee:

FACTS

We own and operate certain mining properties in Polk County in the State of Tennessee. The ore which we extract from the ground is crushed, ground, and then treated by selective flotation processes whereby three separate wet concentrates are obtained—the first containing principally zinc, the second principally copper and the third principally iron.

The zinc concentrate is sold without further processing and presents no depletion problem.

The copper concentrate is melted in a reverberatory furnace, and the resulting matte is transferred for conversion to copper. Here too we have no depletion problem.

The iron concentrate is a mixture of the minerals pyrrhotite, pyrite and magnetite, averaging approximately 55 percent iron and 39 percent sulfur and is in fine powder form (80 percent minus 200 mesh). This concentrate (1) needs further treatment to separate the iron from the sulfur, and (2) the iron, when separated, needs to be brought to a form suitable for shipment. To accomplish both these purposes the iron concentrate is, in substantial part first treated in a roaster as a preliminary to sintering and then sintered. The balance of the iron concentrate is sintered without preliminary roasting treatment. The roasting process drives off the sulfur in the form of sulfur dioxide, and the resultant calcines are then sintered. The sintering process drives off additional sulfur and agglomerates, or fuses, the iron particles into lumps known as iron sinter, which is the form and condition necessary for shipment to, and use by, iron and steel manufacturers. These processes are unique with our company, involving novel and specialized applications in the roasting and sintering art.

DISCUSSION AS TO IRON

The basic problem can be simply stated as follows:

Will our roasting and sintering which separates the iron from the sulfur and agglomerates the iron particles and brings it to the form and condition necessary for shipment, be considered as "mining" under the Treasury bill?

The Treasury has recognized that separation and agglomeration processes applied to low-grade iron ores (taconite) are "mining processes" for depletion purposes. In Rev. Rul. 184, Cum. Bul. 1953–2, 158 the Treasury stated:

"It is held that the grinding or pulverizing necessary to free the ferrous particles from the nonferrous particles, the reducing treatment (magnetic roast) when it precedes magnetic concentrations, the various concentration processes and such processes as filtering and drying incidental thereto, and such agglomerating processes as pelletizing, nodulizing, extruding, or briquetting, when substantially equivalent to sintering, are ordinary treatment processes normally applied by mineowners or operators within the intent of section 114(b)(4)(B)."

Rev. Rul. 184 involved a roast which was applied to a low-grade iron ore for purposes of separting the iron particles by magnetic withdrawal as a preliminary to sintering. Our roasting is applied to an iron concentrate for the purpose of separating the iron particles by driving off the sulfur content as a preliminary to sintering. The end result in both cases is iron sinter. There is no basis for drawing any tax distinctions between iron sinter achieved through magnetic roast and sintering processes, and iron sinter achieved through our roasting and sintering processes.

Under the proposed bill section 613(c)(3)(C) would include within "treatment processes considered as mining" the following pertinent provision:

"(C) * * * (iv) any additional process, if necessary, to bring the mineral or ore to form and condition suitable for shipment; * * *"

Were it not for the subsequent provisions of proposed section 613(c)(4) we might be content with the proposed language and section 613(c)(3)(C) quoted above on the assumption that our roasting and sintering falls within the reference to "any additional process, if necessary, to bring the mineral or ore to form and condition suitable for shipment."

However, the proposed section 613 (c) (4) includes "roasting, calcining" and "treatment effecting a chemical change" among the processes which are not to be considered as mining "unless such processes are otherwise provided for in paragraph (3)".

Although section 613(c)(4) contains the qualifying language "unless such processes are otherwise provided for in paragraph (3)", we fear that the specific references in 613(c)(4) may be construed as preventing the recognition of our roasting and sintering process as "mining" within the meaning of 613 (c)(3)(C). If the Treasury does not intend such adverse and discriminatory results then we suggest that the language be clarified. If the Treasury intends to discriminate between our iron sinter and the iron sinter of other taxpayers then such intention should be thwarted. There is no basis in equity and fair principles of taxation for such discriminaiton. Iron sinter is the same whether it comes for a taconite field or comes from our ores; all necessary treatment processes to achieve the iron sinter state should be similarly considered as coming within the definition of "mining."

DISCUSSION AS TO SULFUR

The Treasury Department has recognized that where an iron sulfide (pyrite) is sold depletion is to be computed on the separate values of the constituent minerals iron and sulfur. (Rev. Rul. 76, CB 1953–1, p. 176.) The code, however, needs clarification to cover the situation where the iron sulfide is not sold (or salable) but instead the sulfur content is released in the iron roasting and sintering processes and is never reduced to elemental sulfur.

The roasting and sintering processes, necessary to obtain iron sinter, separates sulfur, in the form of sulfur dioxide, from the iron content in the iron concentrate. The company's first commercially marketable sulfur products produced therefrom are sulfuric acid and relatively small quantities of liquid sulfur dioxide.

If the first commercially marketable product test is to be eliminated and if any processes prior to the end product are to be eliminated, we believe it is clear that no basis exists for eliminating any process prior to the trapping of the sulfur dioxide for transfer to the company's plants for the production of sulfuric acid and liquid sulfur dioxide.

If the committee were to deem it appropriate or feasible we would have no objection if the company's "gross income" from sulfur was deemed to be equal to or limited to the value of the quantity of elemental sulfur which the company would otherwise be required to purchase from outside sources in order to produce its output of sulfuric acid and liquid sulfur dioxide.

SUGGESTED STATUTORY LANGUAGE

To be assured that our company receives equitable treatment and to clarify the statute we suggest that the proposed section 613(c)(4)(A) be modified to read as follows (proposed additional language is shown in italic):

"(4) Treatment Processes Not Considered as Mining. The following treatment processes shall not be considered as 'mining':

"(A) In the case of all minerals or ores—electrolytic deposition, roasting, calcining (except roasting or calcining of sulphide concentrates), thermal or electric smelting, refining, polishing, fine pulverization, blending with other materials, treatment effecting a chemical change, thermal action, and molding or shaping, unless such processes are otherwise provided for in paragraph (3); and"

The CHAIRMAN. Our next witness is Mr. James L. Child.

Mr. Child will you identify yourself, please?

STATEMENT OF JAMES L. CHILD, SECRETARY-TREASURER OF THE HANCOCK BRICK & TILE CO., FINDLAY, OHIO, ACCOMPANIED BY JOHN C. FIRMIN, ATTORNEY

Mr. CHILD. I am James L. Child, secretary-treasurer of the Hancock Brick & Tile Co. On my left is our attorney, Mr. John C. Firman.

Mr. Chairman and members of the Ways and Means Committee, I am appearing on behalf of that company and the farm draintile industry. The clay used for farm draintile is granted percentage depletion as "brick and tile clay" under the present law and as clay used for "drainage tile" under the Treasury's proposed legislation.

The draintile industry is located in nearly all parts of the United States. However, the big usage of this product is in the States of Ohio, Michigan, Indiana, Illinois, and Iowa, and to a lesser extent in the States bordering those States.

This is the product that I am talking about. This is farm draintile. Our company and many similar companies manufacture farm draintile exclusively. This product is also used for drainage of highways and as a building contruction material for foundation drainage, septic tank drainage, and so forth, but approximately 85 percent of the usage is by the farm community.

Farm draintile has been manufactured in the United States since before the Civil War. It has become an integral part of the farm community in the areas mentioned above and is moving into other areas of the United States in a substantial way.

Draintile is used to remove the excess water from the soil. A typical installation will require 1,000 feet of draintile per acre such as this sample, as well as larger sizes to carry the water into open ditches. The importance of drainage can best be illustrated by the fact that systematically tile-drained land of good quality is worth from $100 to $150 an acre more than equivalent undrained land.

Tile drainage produces better yields and provides the farmer with more consistent income from year to year. Due to early rootgrowth, dry-year production is higher on drained soil than on undrained soil. Earlier planting and later harvesting are among the important advantages. The importance and the advantages of farm drainage are universally recognized, not only by farmers, but by soil scientists and agronomists.

In recent years the unit price of farm production has either been level or has declined, while the cost of preparing, planting, and harvesting each acre has continually increased. As a result, it is becoming an economic necessity to drain wet farmland.

Our industry is not only a small industry, but the companies in it are small companies. The largest factory in the industry has a factory payroll of some 75 people. The average size of the payroll of these companies will be closer to 20 or 30 employees. Normally, each such factory serves the farm community in its immediate neighborhood. For example, northwestern Ohio alone has 15 clay draintile factories.

The treatment processes involved in the manufacture of our product can be briefly described as follows: Clay draintile is manufactured from shale, alluvial clays, and glacial deposits. Some companies, in the case of glacial and alluvial clays, are able to load their trucks or tail cars at the pit and dump these cars directly into a feeder which feeds the material into the pug mill.

Other companies manufacturing clay draintile from the same general type of deposit must run this material through rotary driers removing the excess moisture, following which the material is ground and screened, at which time impurities such as stone and rock are removed. The clay is mixed with water in a pug mill to a plastic mass, extruded in the form of a continuous seamless tube, cut to lengths and placed in driers. After the removal of water the dry clay draintile is placed in a kiln and fired to temperatures varying from 1800° F. to 2000° F., depending on the nature of the raw material being processed. The burnt tile is then removed from the kiln and sold as the first commercially marketable product.

The percentage depletion law refers to the gross income from mining and also refers to the gross income from the property. In the case of our industry, clay draintile is a product that sells for approximately a penny a pound. At such time as the source of clay immediately adjacent to the factory is exhausted, the company, in many cases, is forced to obtain new sources of clay at other locations. The additional cost of a dollar or two dollars a ton for trucking raw material may very well be the difference between profit and loss. In other words, from a practical financial standpoint the entire property is married to the local clay pit.

Our little industry has enjoyed, since the end of World War II, a very active demand for its products. Most of the small companies in this business have not been able to modernize, have not been able to expand production. Due to their size, the nature of their business, and the fact that they were tied to one local source of material, risk capital—the lifeblood of free enterprise—was not available to these companies.

Since the advent of depletion and the resultant ability to retain more earnings, there has been a substantial change in attitude regarding expansion and modernization. There has been a continuous modern tunnel kiln operation built in Ohio for draintile alone, one in Indiana and two in Michigan. I am sure without the availability of capital supplied by the depletion law that these operations would not have been modernized and expanded, thus helping to satisfy the increased demand for draintile.

The burden on these small companies of having years of uncertainty and years of litigation to determine their financial status has undoubtedly slowed down the improvement of the industry. It is felt that the Treasury's draft bill will result in another 6 or 8 years of litigation and uncertainty, leaving these same small companies in an unknown, undetermined financial status with very little additional capital being invested in expanded production facilities.

At the risk of being repetitious, I would like to point out that in connection with brick and tile clay, the Government is asking Congress to change the present percentage depletion law to overcome the so-called adverse effect upon the Government of the decisions in the Cherokee Brick and Tile Co. case and subsequent decisions. The Government's position in those cases was to the effect that the interpretation contended for by the taxpayer and sustained by the courts was that the taxpayer was obtaining depletion on costs of manufacturing, and that it was the intent of Congress not to allow depletion on manufacturing costs. By judicial decisions the brick and tile industry has established that it was the intention of Congress that the brick and tile industry be allowed depletion upon 5 percent of the market value of the burnt brick and tile; therefore, in the present bill, the Government is asking Congress to change its policy in regard to depletion. We oppose any such radical change of the present law.

The CHAIRMAN. Mr. Simpson will inquire, Mr. Child.

Mr. SIMPSON. Mr. Child, I followed your statement with interest. It is a valuable paper and will be helpful to the committee. I am particularly glad to refer to the fact that your congressional district is represented by a distinguished Member of Congress who now serves with this committee, Mr. Betts.

The CHAIRMAN. I think the Chair should recognize Mr. Betts now in rebuttal.

Mr. BETTS. Mr. Chairman, modesty forbids comment. I just simply want to compliment Mr. Child on his statement. I would like to say, Mr. Chairman, that Mr. Child's company represents an important part of the economy in the district I represent. I think it is important too, as he testified, that it particularly fits in the agriculture of that area.

I think as I look over the list of witnesses that he is probably the only witness that is appearing on behalf of the drain tile industry. For that reason I want to compliment him again, and I am sure that his testimony will be helpful.

Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Child, we do appreciate your testimony and your testimony will be helpful to the committee.

Thank you, sir.

Mr. CHILD. Thank you.

The CHAIRMAN. Our next witness is Mr. M. R. Hardin.

Mr. Hardin, please identify yourself for the record by giving us your name, address, and the capacity in which you appear.

STATEMENT OF M. R. HARDIN, EXECUTIVE VICE PRESIDENT, THE W. S. DICKEY CLAY MANUFACTURING CO., KANSAS CITY, MO.; ACCOMPANIED BY CLARK SUTHERLAND, VICE PRESIDENT, ROBINSON CLAY PRODUCT CO., AKRON, OHIO; GERALD O'BRIEN, ATTORNEY AT LAW, INDIANAPOLIS, IND.; AND GEORGE McCLYMAN, TREASURER, ATLAS SEWER PIPE CO., WHITTIER, CALIF.

Mr. HARDIN. First, Mr. Chairman, I want to bring with me Mr. Clark Sutherland of the Robinson Clay Product Co., Mr. Gerald O'Brien, who is an attorney and is familiar with the administrative problems that we have had, to help answer any questions that the committee may have, and Mr. George McClyman, Atlas Sewer Pipe Co., of California.

The CHAIRMAN. You gentlemen may be seated.

Mr. HARDIN. I am with the W. S. Dickey Clay Manufacturing Co., of Kansas City, Mo. My name is Mr. R. Hardin. I am here to testify on behalf of the depletion committee of the National Clay Pipe Manufacturers, Inc., a trade association of the vitrified clay sewer pipe producers of the United States. Our association's membership of 39 companies out of a total of 45 producers represents substantially all of the industry.

On behalf of the clay sewer pipe industry and the members of our association we welcome this opportunity afforded by your committee to present our views on the Treasury Department's proposed amendments to the 1954 Internal Revenue Code and we wish to express our appreciation therefore to the committee and its chairman.

Our thoughts on the Treasury Department's proposed amendments to section 613 of the Internal Revenue Code of 1954 are as follows:

After having had the benefit of the statement by Mr. David A. Lindsay, Assistant to the Secretary, and others testifying before this committee on the Treasury proposals, we think it safe to say that the public hearings have demonstrated the sincere but wide variance between the Treasury's concept of percentage depletion as it presently exists in the law and that of the various mineral and ore extractive industries.

The hearings have been conspicuously absent of any real, sound and reliable economic facts or figures demonstrating that either the percentage rates established by Congress are excessive or that the dollar base to which the percentage is applied, that is, the gross income from the miners' marketable products, should be rolled back to some hypothetical cutoff place.

It should be incumbent upon the Treasury to supply this committee with the actual facts and not theoretical conjectures regarding each of the mineral and ore mining industries involved in its proposal in relation to (*a*) the taxes it pays, (*b*) the depletion deductions claimed

under either cost or percentage depletion, (*c*) the effect of the 50-percent limitation of indirectly reducing the rates allowed, (*d*) the utilization and processing of the natural mineral and ore deposits in the United States, (*e*) the relative scarcity of the mineral or ore deposits in relation to markets, transportation, and demand, (*f*) the capital investment required for plant and equipment necessary to extract and process the minerals or ores, both in relation to past costs and the current inflationary raise in the same costs, and (*g*) the general economic health of each mineral or ore industry in relationship to the rate of dollar return for the exhaustion of natural deposits in the production of income.

We believe it unwise and unfair for the Ways and Means Committee to hastily report out the Treasury's proposed amendments or any of the numerous suggested modifications thereof without giving a thorough and objective appraisal of the whole picture in relation to rate reduction for percentage depletion on the one hand and the fair return on capital to the miners on the other. In the short space of time our industry has had to prepare for this hearing and to analyze the Treasury's proposed amendments we believe the pace at which we are now moving is dangerous and fraught with potential inequity and hardship to the whole mining industry.

We know, gentlemen, when the oil industry first came in for percentage depletion that there was a study made of some 50 companies, taking into consideration many of the things that we have suggested here, no doubt, and while we don't know what the rates should be, whether our rate is too high or too low or whether the cement rate is too high or too low, we do think the committee would be in much better position to act if it had these economic facts available to it.

We therefore propose and urge that the hearings thus far having shown sufficient cause for a subcommittee to be appointed to study the facts, that a cooperative effort on the part of the Government and industry alike be made in order to present all relevant and material facts along the line suggested to a subcommittee for a just solution to the problem raised.

Our industry assuredly does not request that Congress accede to any excessive depletion deductions but we are of right entitled to a reasonable return for the exhaustion of our mineral resources in the production of income. That is all we ask. A proper study will determine the reasonableness of both our percentage rate and capital return on the natural deposits being exhausted.

We realize, of course, that such a study will mean some delay. However, in order to correlate the wide diversity of viewpoints in this critical area of the internal revenue laws such a study is as much in the interest of the Government as that of the whole mining industry. The Treasury has had 1½ years since October 16, 1957, when it announced it would follow the court decisions and the express language of the law, in order to prepare its proposed amendments.

In contrast, the mining industry has had less than 2 months to study the proposed amendments or to formulate amendments of its own. We think our suggestion manifests itself as clearly within the realm of fair play.

Clay sewer pipe must have the necessary strength, chemical resistance, lack of porosity, dimensional control, and other product

characteristics to meet the exacting requirements of Federal and ASTM specifications.

Only a restricted number of clays have the properties and purity to make an acceptable clay sewer pipe. Among the many qualities necessary in the clay mix is sufficient refractoriness so that the pipe does not deform at the high temperatures necessary to produce vitrification. Many other essential characteristics such as plasticity, and the ability to dry and fire into a salable product all impose restrictions on acceptable clays for sewer pipe manufacture.

The importance of proper and adequate raw materials for a clay sewer pipe plant cannot be over emphasized. Upon the quality and quantity of this supply is based the ability to produce a marketable product at a profit. Upon this factor is based the investment of the plant and equipment costing millions of dollars. Clay sewer pipe plants are highly specialized but not highly profitable operations and are not readily convertible to other types of manufacturing.

In order to be sure that this investment is secure, clay sewer pipe companies maintain exploration departments to prospect for new deposits. They are staffed by men skilled in the science of finding clay beds, in many areas a difficult task, in recognizing the potential ceramic properties and in determining the quality and quantity of materials present in the deposits. This determination usually involves core drilling, elaborate and costly sampling procedures, and dozens of laboratory tests on a single deposit.

Test samples must be subjected to all of the processes of pipemaking. These processes need not be covered here as they are adequately described in the accompanying booklet, The Story of Clay Pipe, attached as exhibit B. I would like to suggest that members of the committee read that booklet, especially with reference to the availability of clays and location of the plants in the United States.

If the laboratory tests and all of the other factors appear favorable, plant runs must be made in several sizes of pipe under standard manufacturing conditions. This is the ultimate criteria. As the writer can testify to his sorrow, these plant runs may cost more than all the prospecting, drilling, and laboratory testing procedures before them, and yet may finally indicate that the use of the deposit is not feasible.

A modern clay sewer pipe plant is a highly specialized manufacturing facility which is inescapably wedded to its clay deposits. The characteristics of its grinding and screening equipment, extrusion equipment, and dies, the heat and humidity cycles of its dryers, and the recirculation, burning, and cooling methods in its kilns are all based on the characteristics of the raw material upon which it must feed.

If the clay deposit must be changed for another or its ceramic properties change, the resultant cost in adapting the plant's facilities are enormous. When the clay supply is exhausted, the plant has lost its value unless another source can be located where the clay can be obtained at equally low cost. Because of the low profit margin in the industry, it is impracticable to ship clays into the facility at any great distance under normal competitive conditions.

The history of the industry is replete with examples of clay product plants closing because of a lack or a change of their raw materials.

The clay sewer pipe industry is highly specialized but not a highly profitable industry. Many of the plants are approaching obsolescence by today's standards. Expansion and modernization is definitely

needed in this era of expanding population but because of the low profit potential it is difficult to obtain risk capital and plowed back earnings have not been adequate to meet the needs for expansion in the United States.

In many metropolitan areas in the United States sanitary conditions are deplorable. This problem is highlighted in the December 1958 issue of Fortune magazine—a copy is attached as exhibit C—which introduces the article by stating:

> Politics, apathy, and the headlong rush to suburbia have made water and sewage facilities the greatest single deficiency in the U.S. public works and the way things are going, we may not catch up for 40 years.

The article further states:

> The Business and Defense Service Administration of the U.S. Department of Commerce, estimated that some 40 million people need new or improved sewage collection systems.

That is worthwhile reading too, gentlemen, to see what the sad situation is in this country in our sanitation facilities.

The clay pipe industry is highly essential to the health and welfare of our people. During World War II the industry was unable to supply the demand for military and defense installations. Vitrified clay pipe was specified exclusively for the Oak Ridge, Tenn., atomic plant and our industry furnished literally hundreds of miles of vitrified clay pipe for that project.

Similarly, vitrified clay pipe specifications were contained in many other military projects but the industry was unable to satisfy all such demands and in many instances it was necessary to use short-life substitutes in order to speed up construction.

Members of the clay pipe industry are well aware of the need for new plants to increase production for tomorrow's needs and are moving forward in that direction within their limited financial ability to do so.

The industry refused to accept subsidies following World War II and has never asked for any special governmental handouts. Continuation of the allowance for percentage depletion under the law as now written will provide our taxpayers with some of the funds which will be needed to finance expansion and modernization.

We suggest that the Treasury Department's statement that the revenue loss will approach 603 million is pure conjecture. Even so, we have just completed a survey of 39 taxpayer companies—comprising 72 out of the total 82 sewer pipe plants in the United States—for the purpose of ascertaining the amount of percentage depletion claimed in Federal returns and we have the following figures for the year 1957 which we believe to be quite accurate:

The reduction of taxes to our taxpayers for the year 1957 as a result of percentage depletion amounted to $2,356,000. That is $32,700 per plant or $60,400 per taxpayer.

According to the reports of the Department of Commerce, Bureau of Census, the sales volume of clay sewer pipe in the United States for 1957 was $90,120,000. The sales volume from the 72 plants covered in this survey is estimated at $75,134,000. This tax effect to the taxpayer as shown above—$2,356,000—represents only a 1 percent return on average capital investment in deposits, plant, and processing equipment at today's replacement cost.

This certainly is not large enough to be a serious loss in revenue to the Government or a windfall to the taxpayers. Although the allow-

ances, 15 percent for fire clay and 5 percent for other clays might lead the uninformed to believe that the tax effect would be much greater, it must be remembered that the allowance is restricted to 50 percent of net taxable income. Comparable figures for 1958 are not available, but it is safe to say that the 1958 allowance to our taxpayers is less than for 1957.

We can safely state that the depletion deduction afforded the sewer pipe industry following the allowance of percentage depletion to fire clay and shale in the Revenue Act of 1951 has been insufficient to meet these costs of clay exploration and plant modernization or expansion. The sewer pipe industry has been required to finance these costs by borrowing large sums of money running at the present time in excess of $30 million.

The problem of further exploration and plant investment is extremely acute since the Treasury adamantly refuses to refund the overassessment of taxes paid by our industry.

A typical situation of our industry was faced by W. S. Dickey Clay Manufacturing Co., where it was required to abandon six plants—three in Georgia, one in Illinois, and two in Missouri—because of the depletion of clay deposits supplying these plants. Losses sustained in these abandonments, representing the undepreciated costs of the plants, exceeded $1 million.

Deposits of refractory and fire clays are far more rare than deposits of low-grade clays because of the more restrictive set of conditions under which they are formed and deposited. The present 15-percent rate of depletion under section 613(b) of the 1954 Internal Revenue Code recognizes this difference in supply. The necessity for the use of fire clay in the manufacture of clay sewer pipe in order to produce the required product characteristics, with the high temperatures necessary for vitrification, has already been described.

We strenuously oppose the Treasury Department's proposal (sec. 613(b)(5)(B)) that any fire or refractory clay when used in sewer pipe would be allowed only 5 percent regardless of the true nature of the clay consumed. The proposal obviously discriminates against the user of fire clay in the production of vitrified clay sewer pipe as in other products was recognized even by the Internal Revenue Service in Revenue Ruling 56–59 (1956–1CB 626), as follows:

> A clay will be considered a "refractory and fire clay" only if it is used for a recognized refractory purpose. In this connection, fire clay used to enable sewer pipe to retain its shape and dimensions under extremely high temperature required for vitrification is considered to be used as refractory clay.

It is submitted, therefore, that if "clay used for purposes dependent on its refractory properties" is to be subject to the 15-percent rate, as proposed, it should be subject to such rate when used in the production of sewer pipe as well as in the production of other refractory products.

A method of eliminating discrimination between miners would be to delete "sewer pipe" from proposed section 613(b)(5)(B) of the Treasury Department's proposal. No explanation was offered by the Treasury for singling out the clay sewer pipe producers for this arbitrary treatment of fire and refractory clay deposits. We submit none exists.

By way of some general observations we protest against the Treasury's proposed amendment of the definition of "mining" in section 613(c) of the 1954 Internal Revenue Code, by which the Treasury

proposes to delete the "commercially marketable mineral product or products" test, substituting in lieu thereof a narrow and restrictive checklist of processes, for the following reasons:

First, the underlying thesis of the "process" approach of the Treasury is a misnomer, because percentage depletion is not based on any process, whether it be a mining or so-called manufacturing process, but upon a dollar base to which the applicable percentage applies.

Secondly, Congress elected back in the Revenue Act of 1943 to use the commercially marketable product rule as a simple means to provide this dollar base.

Thirdly, with the dollar base established Congress can easily, if it wishes, for each mineral, adjust the rate of percentage depletion without disturbing the dollar base.

The Treasury's proposal of replacing the present established definition of mining, which has had repeated judicial sanction, with an entirely new, untested, and confusing definition based upon an exclusive list of processes, is a complete and unwarranted departure from the basic concept of percentage depletion.

The Treasury proposes to:

(*a*) Roll back the dollar base by elimination of the marketable product rule.

(*b*) Substitute for all the ordinary treatment processes normally applied only certain exempt processes.

(*c*) Introduce a new base to which the percentage rate applies in the form of a transported product or products.

(*d*) Disallow any mining process following a "nonmining" process.

The marketable mineral product of our industry is vitrified clay sewer pipe. The clay in our deposits is shaped and hardened into pipe, and the pipe contains the same nonvolatile chemical constituents as at the beginning of processing. To achieve proper and controlled hardening, firing or burning of the clay is necessary. The burning process is less complicated than many so-called mining processes allowed in the Treasury definition, such as cyanidation, leaching, crystallization, precipitation, furnacing, sintering, and nodulizing. There exists no rational or logical distinction between our process of burning and the above-listed processes, or the burning of magnesite.

Molding and shaping of the clay is as much a preliminary process as crushing and grinding is a preliminary process in preparing quicksilver ores for furnacing. Permissible processing should include any necessary treatment process applied in order to obtain a commercially marketable product or products, which is presently the rule allowed by Congress under the 1954 Internal Revenue Code.

We join with other members of the mining industry in objecting to the so-called sudden death clause whereby any mining process following a so-called nonmining process would not be considered as mining for purposes of percentage depletion in the Treasury's computation. There is no virtue in either "checklisting" processes or instituting a "countdown" approach to processing. The numerical order in which a process is applied has no sensible basis in the minds of reasonable businessmen as to whether the process is or is not allowable for computation or percentage depletion.

We wish to make our position perfectly clear that we recognize Congress has under its constitutional power the right to levy and

collect taxes, but it is equally true there is a reserved right of the people to be protected against tax upon their capital.

The power of Congress to tax income did not originate until 1913, when the 16th amendment of the Federal Constitution was adopted. Concurrently therewith, Congress passed the Income Tax Act of 1913, where Congress provided for depletion on exhausting mines and natural resources, in section II G, and stated in the case of mines and natural deposits there would be allowed a deduction for depletion based upon the "gross value" or sales price of the mined product.

Congress next enacted what is called cost depletion in 1916, and then "discovery value" depletion in 1918. Conflicts between Treasury and taxpayers arose over the discovery value and extent of unknown mineral deposits and the recoverable mineral after processing, so that Congress adopted the percentage depletion method—first, in the case of oil and gas in 1926, then for metal ores, coal, and sulfur in 1932, and shale and fire clay in 1951.

Congress heard the complaint that the Treasury unexpectedly altered its concepts beginning in 1943 of what were allowable mining processes in the computation of percentage depletion and Donald H. McLaughlin of the American Mining Congress, in hearings before the Senate Finance Committee on the Revenue Act of 1943, stated that the Commissioner of Internal Revenue was breaking an informal agreement with the Members of Congress who sponsored percentage depletion, that normal processing would be allowed in order to arrive at a marketable product base.

Congress thereafter avoided placing further responsibility in the hands of the administrative officials and drafted a definition of "gross income from the property" which completely departed from the mining versus manufacturing concepts raised by Treasury at that time. In fact, the conflict centered around the Commissioner's contention that "furnacing" cinnabar or quicksilver ore was manufacturing.

Congress made the statutory definition of mining retroactive to December 31, 1951, thereby expressing its understanding of what it originally intended, that is, the percentage depletion would be computed on a marketable product base.

In complete disregard of Congress, the Treasury next advanced its "mining" theory against the talc industry claiming that molding and shaping of talc crayons and fine pulverization of talc into powder were manufacturing processes. This was rejected both by the Tax Court, and the Fourth Circuit Court of Appeals. Despite these setbacks, Treasury forged anew its ethereal definition of mining in the now repudiated Treasury Decision 6031, whereby the Treasury excluded any process effecting a chemical change, blending, thermal action, fine pulverization, molding and pressing into shape, which this time was directed at the clay miners.

The now famous case of *Cherokee Brick and Tile Co.* v. *United States*, rejected the Treasury's theories by observing mining "cut-off" concept was "confusing" and without certitude, and that the proportionate profits method in substitution of the marketable product rule was "obviously a pure fiction which might be false more often than true."

Once more, the unbiased judges looked askance at the Treasury's theory of mining versus manufacturing and variously characterized it as a "purely hypothetical concept," "ignores entirely the realities,"

leads "to confusion rather than clarification," "untenable," "clearly contrary to the language used by Congress," "without merit," "invalid," and a "fallacy."

It is difficult to conceive how in good faith what was described as manufacturing so recently by the Treasury Department mysteriously becomes mining in those instances of "furnacing" of quicksilver ores and the "pulverization" of talc in the Treasury's proposed amendments (sec. 3(d)).

It would be unwise for Congress to adopt such a mining definition where its meaning is peculiarly subject to administrative fiat. The Treasury fails to set forth any objective criteria by which anyone can measure the reasonableness of the selected process to be covered under "mining."

We agree with the repeated statement in these hearings that the "freeze" the Treasury seeks to place on processes will lead to eventual crippling of technological advancement.

Instead of avoiding further litigation the Treasury proposal is so replete with undefined terms having hidden meanings known only to the Treasury's draftsmen, such as, "crude," "free," "necessary," "form," "condition," "suitable," "capable," "salable," "similar," and "blending," that the mining industry will be inextricably drawn into further expensive court litigation any time it disagrees with the Treasury definitions.

We do not believe sufficient emphasis has been placed on the discriminatory treatment accorded some miners where the Treasury proposes to permit certain mining industries namely coal, sulfur, and metals of the ores, to compute percentage depletion on a marketable product base but under a proposed "transported product" base. There is no distinction between processing to arrive at a transported product and processing to arrive at a marketed product.

It would be wrong to allow a double standard to creep into the law where some mines would be allowed to compute percentage depletion on the dollar base of their transported marketable product and others would be required to "roll back" from the dollar base of the transported marketable product merely to satisfy the Treasury's concept of "mining."

This points up again the error of attempting to apply percentage depletion to any dollar base other than the commercially marketable mineral product of the particular miner.

Under the Government's cut-off theory, the computation of gross income for determination of percentage depletion will have to be based on the proportionate profit method which in turn is the relationship between the cost of allowable and nonallowable processes.

It logically follows that all other considerations being equal the operator with the higher mining cost will receive a greater depletion return and solely thereon.

The Treasury's proposed regulation under the 1954 code and published in November 1956, would not, in our opinion, change this situation.

By way of further explanation, the following table dramatically demonstrates the inequity of allowing depletion on partial costs, per ton:

	Low cost mining department sewer pipe manufacturer	High cost mining department sewer pipe manufacturer
Cost of ordinary treatment process	$2.00	$7.00
Subsequent costs	20.00	20.00
Total costs	22.00	27.00
Proportion of ordinary process to total cost (percent)	9	26
Selling price	$40.00	$40.00
Amount subjected to depletion	3.60	10.40
Assuming 50–50 mix, fire clay and shale with 15 percent and 5 percent rates, depletion allowance	.36	1.04

It is apparent from the above that the proposed bill would inflict a hardship on a small but vital industry. It would discourage the building of the clay sewer pipe plants we will need to adequately carry the human and industrial wastes of the future to protect our Nation's public health and welfare. The proposed bill is discriminatory against the clay sewer pipe industry which requires the use of fire clay in its products.

It is also discriminatory in that the depletion allowance will be greater for some manufacturers than for others due to variations in costs of "ordinary treatment" processes.

We gentlemen, are definitely opposed to the enactment of this bill.

EXHIBIT A

APPENDIX OF CITATIONS

1. C. 63, 58 Stat. 21, 45.
2. *Dragon Cement Co.* v. *United States*, 244 F. 2d 514 (C.A. 1st, 1957); *United States* v. *Cherokee Brick and Tile Company*, 218 F. 2d 424 (C.A. 5th, 1954); *United States* v. *Sapulpa Brick and Tile Corp.*, 239 F. 2d 694 (1956); *United States* v. *Merry Brothers Brick and Tile Co.*, 242 F 2d 708 (C.A. 5th, 1957).
3. C. 16, 38 Stat. 114, 116.
4. C. 463, 39 Stat. 756.
5. C. 18, 40 Stat. 1057.
6. Treasury Regulations 45, art. 206(b), promulgated, January 28, 1921.
7. C. 27, 44 Stat. 9, 16.
8. C. 209, 47 Stat. 169, 179.
9. Hearings, 78th Cong., 1st sess., vol. 2, pp. 527–529.
10. See, *New Idria Quicksilver Mining Co., et al.* v. *Comm.*, 144 F. 2d 918 (C.A. 9th, 1944), reversing 2 T.C. 412 (1943).
11. *International Talc Co.* v. *Comm.*, 15 T.C. 981 (1950).
12. *Townsend* v. *Hitchcock Corp.*, 232 F. 2d 444 (C.A. 4th, 1956).
13. 1953–2 Cum. Bull. 120.
14. 218 F. 2d 424 (C.A. 5th, 1954), affirming 122 F. Supp. 59 (Ga. 1954).
15. *International Talc Co.* v. *Comm. supra.*, p. 988.
16. ibid.
17. *Cherokee Brick and Tile Co.* v. *United States*, 122 F. Supp. 56, *65* (Ga. 1954).
18. *Hitchcock Corp.* v. *Townsend*, 132 F. Supp. 785, 787 (N.C. 1955).
19. *Townsend* v. *Hitchcock Corp.*, *supra*, p. 446.

20. *Merry Brothers Brick and Tile Co.* v. *United States*, 56–2 U.S.T.C. 9821, at page 56, 126.
21. *Dragon Cement Co.* v. *United States*, *supra*, p. 520.
22. *The Sparta Ceramic Co.* v. *United States*, 58–2 U.S.T.C. 9965 at page 69, 825 (N.D.E.D. Ohio).

EXHIBIT B

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THE WORST PUBLIC-WORKS PROBLEM

Politics, apathy, and the headlong rush to suburbia have made water and sewerage facilities the greatest single deficiency in U.S. public works. And the way things are going, we may not catch up for 40 years

(By Edward T. Thompson)

Fourteen miles southwest of downtown St. Louis is a subdivision of $30,000-to-$50,000 homes called Ronnie Country Club Acres. Its 25 families are happy in homes in such a desirable neighborhood—until it rains. "Then," says one despondent resident, "the septic tanks overflow and sewage lies in the yards or runs down the street." The people of Ronnie Country Club Acres have spent a lot of money trying to rectify the condition by improving drainage fields or putting in storm drains. The owner of one of the houses secretly installed a pipe that takes any overflow from his septic tank and discharges it alongside the State highway. But none of these expedients has solved the problem; it's still unpleasant when it rains on Ronnie Country Club Acres.

The situation that has overtaken these St. Louis suburbanites, with their large investments, is one that is familiar across the United States; it is one small item in the most neglected of all the public-works problems arising out of postwar prosperity, mobility, and population growth. Fortune, in the previous articles of this series on public works, has analyzed the highway situation, into which the Government may be charging blindly, but at any rate is charging, and the vast school-building program that is actually catching up on the famous "classroom shortage" of a few years ago. But water supply and sewerage, as this concluding article shows, remain a signal failure in public works. These vital deficiencies are being attacked haphazardly, reluctantly, and locally, instead of on an areawide basis, which is the only effective approach. And not only are water and sewerage facilities woefully deficient, their potential as a powerful tool for shaping communities is being almost totally overlooked.

Not surprisingly, the deficiencies in both sewerage and water facilities, which have been growing steadily more serious for nearly 20 years, are most serious in the sprawling suburbs. The Nation's exploding metropolises have filled the country with a hodgepodge of water and sewer systems bounded by political lines instead of natural drainage basins, systems that were often inadequate even before they were completed, much less paid for. The U.S. Public Health Service, in a community-by-community survey, found that nearly half of the 100 million Americans who have community sewers do not have adequate sewage treatment facilities. The Business and Defense Services Administration estimates that some 40 million people need new or improved sewage-collection systems. BDSA also says tht almost half of the 117 millon people who use public water supplies can't be sure of having enough water available on a hot summer day to put out a major fire.

It is relatively easy to stir up indignation over industrial pollution, a well-publicized problem that will be solved, if at all, by private, not public, works. Similarly, it is not hard to gain support for such water projects as the Missouri River Basin program, which through flood control, irrigation, and new power sources will change the fortunes of huge areas of the country. But sewer and water needs are less visible. The ordinary householder is satisfied as long as clean-looking water flows from his faucets, and as long as the sewage goes someplace where he can't smell it.

In all, says BDSA, the U.S. investment in municipal sewerage systems is at least $6.9 billion short of what it should be, and in waterworks is short by $4.6 billion of the needs. In the next 17 years, to correct today's deficiencies, and to provide for the expected surge in population and for depreciation of existing facilities, BDSA estimates, the Nation should spend at least 44 billion on waterworks, sewers, and sewage treatment plants. This would mean spending $2.6 billion a year—which is about twice the average rate of outlays for this purpose since 1946. Of the two problems, water and sewage, the latter is by far the more critical. Says one BDSA official: "I don't think the municipalities will catch up on sewers for 40 years."

MORE PEOPLE, MORE WASHERS

The United States has no absolute shortage of water. The shortage is one of reservoirs, transmission lines, and pumps; these have not been adequate since 1940. During World War II new waterworks construction was virtually nonexistent, and from the end of the war through the Korean emergency, rising costs and material shortages kept the pace of construction well below what was needed to keep up with the population. Since 1940 practically all of the increase in population (from 132 million to 175 million) has been in urban areas; the population dependent on public water supply, says BDSA, has risen from 82 million to 117 million. At the same time, the advent of such appliances as automatic washers has raised the per capita consumption of public water from 122 gallons to 160 gallons per day. By 1975 some 149 million people (of a total population of 209 million) will be in communities with public water, and their per capita needs will be at least 200 gallons daily. The total cost of new waterworks construction needed between now and 1975 is put at around $20 billion.

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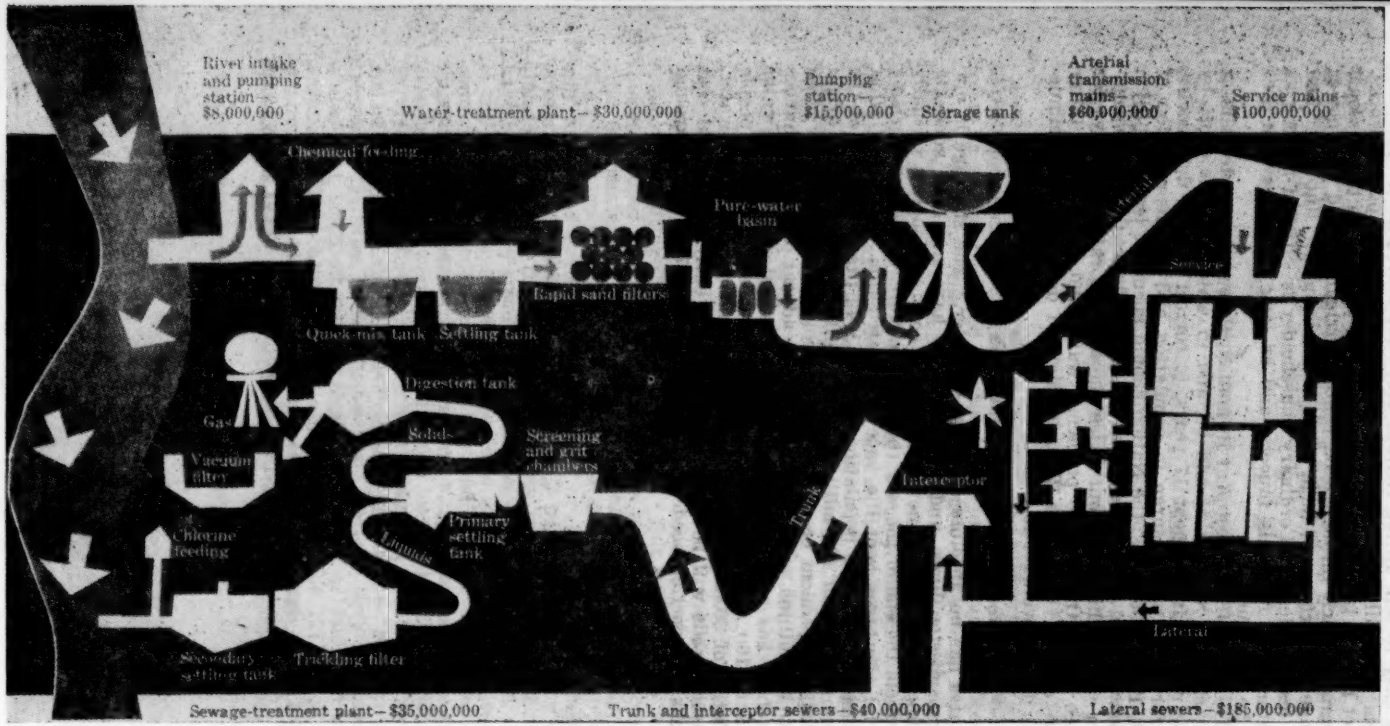

This is an ideal that no U.S. metropolitan area has achieved. It is a diagram of the kind of modern water and sanitary sewerage system that Black & Veatch, Kansas City consulting engineers, consider adequate for an average midwestern metropolitan area of 1 million residents. Its hypothetical cost: $473 million. Actual investment might vary from $240 million to $700 million, depending on topography, population density, subsurface soil conditions, and other local factors, and an additional investment of at least $100 million would be needed to provide satisfactory storm sewers. The water and sewerage problems cannot be separated. Up to 95 percent of the water that is purified and distributed to users must be disposed of as sewage; in a metropolitan area this requires an extensive system of lateral and interceptor sewers leading to a modern treating plant that removes 70 to 90 percent of organic pollutants from the sewage. **The natural purifying ability of the river (or bay or lake) takes care of the rest, and thus the people in communities a few miles downstream can use the water in their homes.**

By 1975 at least 134 million people will be in areas with public sewerage, compared to 100 million today. To provide them with adequate sewage disposal, $24 billion should be spent. A great part of this spending is needed for sewage-treatment facilities. Until recently, most sewer systems were considered adequate if they simply provided collection lines. The raw sewage could be dumped, as it still is in St. Louis, New Orleans, and many other areas, into a convenient stream or river, which through dilution and natural bacteria action would often purify itself within a few miles. But as population became more dense, the amount of raw sewage discharged began to exceed the purifying capacity of the streams. Federal and State authorities agree that the Mississippi just below St. Louis is highly polluted. Most large cities and many smaller communities recognized the dangers of pollution and built so-called primary treatment plants—in effect, settling tanks that reduce organic pollution by about one-third. Now, however, the quantities of sewage have risen to such a level in areas like Denver and Washington, D.C., that more intensive treatment is needed—secondary treatment, which, by aeration and settling, leaves the effluent 70 to 90 percent clean. Primary treated sewage from Denver now enters the South Platte River, which is a source of irrigation water for downstream farmers; even though the State warned of a health hazard in 1956 and recommended secondary treatment, Denver is still not spending the necessary money.

NO SALES APPEAL IN SEWERS

Besides the sheer population growth, a complicating factor in the problems of water and sewerage is the pattern of that growth. When new houses are erected on sites contiguous to build-up areas, it is a relatively simple matter to extend community water and sewer lines to them. But the subdivider, in his search for cheap land, generally jumps out into the countryside, then tries to persuade the city to bring water to him. Usually he is willing to pay for the installation of water lines within his development, plus at least his proportionate share of the water main from town. In most cases, the town is willing to pay the incremental costs because it can be fairly sure it will recover them in increased water revenues as the area builds up. Sometimes, however, as in many parts of Florida that have a high water table, the cost of bringing water from town is greater than drilling a central well or wells at the development, so the developer builds the facilities and then either goes into the water business himself, or deeds or sells the equipment to a private utility. In either case, the homebuyer pays the cost in the price of his house.

Sewerage is another matter. A developer may install sewer lines, pay for the trunkline from town, add the cost to the prices of his houses, and leave the owner with a permanent system. But most developers don't operate that way. Unlike a good water supply, which practically all buyers insist on, sewers have little sales appeal. Buyers seem to ignore the rather obvious fact that up to 95 percent of the water that enters a house must be carried away by some sort of mechanical means. So the developer put in septic tanks at perhaps two-thirds the cost of sewers, without, of course, informing the buyer that these devices may be adequate for only 5 to 10 years, and that in the meantime there will be maintenance costs. When the septic tanks start giving trouble, the house owners often find that the only solution is a sewer system. Then they not only have to write off their investment in the septic tanks, they have to pay considerably more for their sewers than they would have when the houses were built because properties and streets have to be torn up.

Septic tanks are all right if certain conditions are met: if the drainage field is big enough and the soil drains easily. Authorities agree, however, that the average development lot of less than a quarter acre is seldom sufficient even with the best possible conditions.

BREAK UP THE COMPETITION

Planners and engineers, in a rare display of unanimity, believe strongly that metropolitan action is vital if the country is to get the kind of sewerage it needs. They cite several reasons for their belief. Individual municipalities within a metropolitan area do not pass the laws necessary to curb the installation of septic tanks; each town is afraid that if it is too strict with a developer he will simply build his houses elsewhere. The separate towns can't or won't do anything to bring uniformly high standards to the multiplicity and variety of sewerage systems that already exist in every metropolitan area. On the Virginia side of the Potomac River across from Washington, for example, there are 14

organic pollutants from the sewage. The natural purifying ability of the river (or bay or lake) takes care of the rest, and thus the people in communities a few miles downstream can use the water in their homes.

sewage-collection agencies operating 19 treatment plants (only 1 gives secondary treatment); in addition, there are 70,000 people without sewers at all.

The lack of concerted action is due partly to the fact that the man at the top of the hill just doesn't care about the problems of the man at the bottom. Sioux City, Iowa, for instance, despite long-standing complaints from people downstream on the Missouri River about pollution, has refused to build a sewage-treatment plant. Moreover, "clusters of governments can't make overall policy," as Robert Wood, political scientist at the Massachusetts Institute of Technology, points out. "One city can make its own residents happy, but not much else. Even if governments want to solve problems on a broad scale, officials are hamstrung by outdated laws and the nationwide scramble for resources. We need to break up the competition among communities." Sewage treatment makes sense, of course, only if an entire area participates. There is little incentive for one town to clean up its sewage if 30 others around it aren't equally conscientious.

Finally, argue the planners, there is the economic advantage of metropolitan sewerage. The capital investment required for a treatment plant to serve 500,000 people is only about three-quarters as much per capita as for one that serves 50,000 people in the same area; per capita operating costs are also usually less in a big plant.

These are not necessarily arguments for establishing overall metropolitan governments; but they are potent arguments for setting up public-works authorities able to operate on a metropolitan scale.

MOSCOW OR SEATTLE

Seattle and its environs are typical of what planners call the conglomerate mess of suburban sewer facilities, and of what can happen when communities fail to take an area-wide approach to the problem. The Seattle area now has a population of about 850,000, over 65 percent of it within the city limits, the rest in surrounding fringe communities. The area is expected to have a total population of a million and a quarter by 1980 (only half of it inside the city limits). Until this summer sewerage service was controlled by 49 agencies.

Though there are 25 sewage-treatment plants in the area, raw sewage from about 425,000 people is regularly discharged at 60 different points into Puget Sound, the Duwamish River, and Elliott Bay. Treated sewage from 80,000 people enters Lake Washington directly from 10 treatment plants and indirectly from at least 4,000 septic tanks. In addition, when it rains heavily, overflows of raw sewage enter Lake Washington and Green Lake more than 40 times per summer. As a result, the concentration of certain plant nutrients, mostly phosphorus and nitrogen, has increased to the point where plant life is choking the lake.

About one-third of the total population is without public sewers, and to keep up with residential development some 6,000 private septic tanks are being built annually at a cost of $2 million. Engineers consider many of these no better than a temporary solution. Much of Seattle itself uses combined sewers that carry both sanitary sewage and storm runoff (a situation common to most big cities). Because of inadequate provision for storm flows, many of these sewers overflow when it rains, flood basements, and discharge sewage into streets.

The logical area for future growth is around Lake Washington, but its greatest attribute—the lake—is being ruined. The communities on the eastern shore of the lake recognized the problem, and also recognized that they could solve it only in concert. So 3 years ago the towns tried to get together on a joint trunk sewer line that would take the sewage out of the lake and put it in Puget Sound. But the well-intentioned attempt quickly turned into a battle. Two of the communities, Bellevue and Lake Hills, couldn't agree on what plan to adopt; nothing got built.

Meanwhile, a group of private citizens led by James Ellis, an earnest young attorney, and strongly encouraged by Seattle's able mayor, Gordon S. Clinton, had been pushing the cause of metropolitan government for the area. Ellis, in fact, had helped draft a new charter for King County, in 1952, which would have created a county-manager form of government. Opposition slogans such as Is This Moscow or Seattle? plus the lack of a compelling reason for administrative change killed it at the polls.

In 1956 the city and county finally did get together to finance a $130,000 sewerage study by Brown & Caldwell, San Francisco consulting engineers; the State pollution-control commission contributed $10,000 toward the study. Con-

currently, Ellis' group drafted and pushed through the State legislature in 1957—by one vote—a law that allowed the formation of a Metropolitan Municipal Corporation empowered to plan, finance, and administer six services for the area: Sewage disposal, water supply, public transportation, garbage disposal, parks and parkways, and comprehensive planning. In March of this year metropolitan Seattle residents were presented with an abbreviated proposal to create such a corporation with authority over sewerage, public transportation, and comprehensive planning.

SAVE LAKE WASHINGTON

But even this was too much for the voters. The proposal passed in the city of Seattle, but was defeated in the areas outside. "The county areas were afraid of a supergovernment dominated by the city," says Mayor Clinton. Plans were made immediately to have a new vote in September, but this time on an even more abbreviated version of the first plan. The corporation would have authority only over sewerage; local autonomy would be strictly observed; the area to be covered by the authority, originally 575 square miles, was cut about in half. Perhaps most important, a single issue was dramatized: "We must save Lake Washington." The people at last voted yes.

Brown & Caldwell had recommended that two large treatment plants be built (one south of Seattle, one north); these will be fed by two huge interceptor lines that will pick up the sewage from present and proposed collection lines. Because of ridge topography in some areas, seven small additional treating plants will be built. Total treating capacity is to be nearly 300 million gallons per day, enough to last the area for 75 years. The proposal called for a 3-stage program to cost $83,200,000 in the first 10 years, $35,400,000 in the second 10, and $45,400,000 in the final stage. All the first-stage projects and the most pressing parts of the second are in the geographical area covered by the new authority, and are now being studied in detail. (The report also recommended that the city of Seattle spend $69 million of its own money to separate storm and sanitary sewers.)

SO NOTHING GETS DONE

Ardent planners may not be too happy about Seattle's plan. They argue that first things should come first, and in their book the first thing is a metropolitan government that can handle all the problems of areawide significance. Once the organization is established, it can attack the specific problems.

This argument has an orderly sound and, in fact, it is precisely what James Ellis and other Seattle Metro backers wanted in the beginning. But when, as happened in Seattle, the people of the area decide they just don't want a supergovernment, the argument breaks down; urgent and specific problems don't get solved. In the region around Nashville, Tenn., for example, better sewerage is badly needed, and the planners tried to use the situation as a lever to set up metropolitan government. Metro was so soundly defeated in Nashville last June that the chances are it will not be proposed again, or at least not very soon. Meanwhile, no steps are being taken to get an areawide sewerage authority, and the potential hazard to health increases.

Partly because of sewerage problems, the people of Dade County, Fla., voted in 1957 to adopt metropolitan government. (It is the first, and so far only, large area in the United States to try this system.) But Dade's metro government has been so harried by political problems that only the barest start has been made to meet sewerage needs. A sewer authority elected in 1957 would almost certainly have been much further ahead.

Independent authorities pose some difficulties, of course. As Fortune has pointed out (New Strength in City Hall, November 1957), they can easily become a power unto themselves. Being nonpolitical appointees, the commissioners may hold themselves aloof from normal democratic pressures; this is fine if upstream and downstream views don't compete, but, particularly in water and sewerage problems, they almost always do. Moreover, there are many organizational and public-relations problems in setting up a metropolitan water or sewer authority. For example, should communities that have already solved their problems be required to surrender their expensive facilities to the agency, and in addition help pay for facilities for their less foresighted neighbors?

But the fact is that metropolitan water-and-sewer authorities are operating successfully, and have been for some time. Both Boston and Chicago have had metropolitan sewerage agencies since 1889, the Metropolitan Water District of Southern California was created in 1928 to provide water for the Los Angeles

area. In every case, despite the problems and drawbacks, these authorities are doing a far better job than the individual communities in the areas ever did, not only of correcting water and sewer deficiencies, but of planning ahead for an expanding population.

GOOD GAMBLE

Once water and sewer lines are installed, population builds up around them. It is possible for a metropolitan authority to put lines in sections where it wants population to expand and withhold them from sections it wants to keep for open space. Water and sewer facilities can be an even more useful weapon against urban sprawl than zoning laws. But they are seldom used this way.

Similarly, water and sewerage can be used to attract industry. Many cities and towns will agree happily to provide such services to a company if it will formally decide to locate within the town's boundaries. But almost no communities in this country have been willing to take the next important step, that is, to build water and sewer lines into an area not currently industrialized so that the chamber of commerce can then say to industry: "We're ready for you right now, no waiting."

The arguments of the politicians against both of these policies go something like this: "We have so many existing needs that we can't even think about building out ahead of population growth or in anticipation of new industry; we can't afford to put in lines that maybe nobody will be using for several years; we can't afford to gamble with the public's money." But with the flight to suburbia almost certain to increase rather than diminish, and with practically every community in the Nation scrambling to get choice industry—research labs, electronics firms, etc.—it may well be a bigger gamable not to be ready ahead of time.

WE CAN'T AFFORD ANY MORE

The most common response of local officials when asked why they aren't tackling their water and sanitation problems more vigorously is, "We know we're way behind, we know we're polluting our river, but we just can't afford to spend any more than we are." What they mean is that they won't spend any more.

It is true, as the diagram on page 103 shows, that water and sewer projects are expensive. New York City, which may face the threat of having to close its beaches because of pollution, recently estimated that it would have to spend some $170 million just to separate sanitary and storm sewers, and another $110 million for one sewage-treatment plant; nobody knows for sure what total metropolitan New York needs are. Also, many communities are at, or near, their legal or economic general debt limits, and thus find it difficult to borrow money. But legal debt limits are arbitrary, they can be changed; and economic limits are set by available revenues, and these can be increased.

Water and sewerage are services, and, as such, charges can be made for their use. The total income after operating expenses is highly predictable and can be used to pay off bonds. This is the way all private utilities operate. But public water charges are, on the average, too low to provide the necessary revenue. Sometimes they do not even cover operating expenses, and even when they do, any surplus usually goes back into the city treasury to cover deficits from other services. One estimate is that if each person in the country would pay about 1½ cents more per day for water (an increase of about 50 percent over the mean U.S. per capita water rate), the accumulated deficiencies in water facilities could be wiped out by 1970 and that from then on new waterworks could be financed out of earnings. As for sewerage, few communities make any identifiable charge at all; operating costs are paid out of general taxes. Thus, even for the smallest capital expenditure, it becomes necessary to float a general bond issue.

NO PRESSURE ON CONGRESS

Rather than make the politically unpopular move of raising service charges, many communities talk wishfully about increased State or Federal aid. They are not likely to get it. There are no figures available on the total amount of State aid for local water and sewer projects. But the States' general indifference to these local needs is indicated by the fact that currently only four States (Maine, Maryland, New Mexico, and Vermont) are willing to give any grants

at all toward the construction of sewage-treatment plants; the total amount of State funds appropriated in the United States is less than $7 million. In California, which estimates that $600 million should be spent on sewerage works through 1960, the only State aid to municipalities is a $1 million revolving loan fund. Some experts argue that the States should be doing far more than they are. They say the States should emulate Texas, which last year created a State water-development board that can issue up to $200 million in State general obligation bonds for local water projects. Texas municipalities will save a considerable amount in interest charges because of the State's generally superior credit rating.

The Federal Government has spent practically nothing on municipal waterworks and sewerage systems since the massive WPA and PWA programs of the thirties; since 1956 it has appropriated a trifling $50 million a year [1] for construction of sewage-treatment facilities. Last spring a bill to double the amount of sewage-treatment grants died in the House Rules Committee. And now there are indications that the whole program may be replaced by one that would relinquish some $145 million a year of Federal telephone-tax money to the States. The States would not have to use this money for public works, and, judging by current State public-works policies, it seems unlikely that much of it would be used to build sewage-treatment works.

In view of the enormous pork-barreling potentials inherent in water and sewerage deficiencies—far greater, for example, than in river and harbor maintenance—Congress' lack of interest in the problem is surprising. But it also indicates the public's indifference to the problem: people don't even bring pressure on their Congressmen to get them Federal help.

A QUARTER SAID NO

Water and sewer facilities will be a lot more costly in the future than they are now. The cheapest water sources are already being exploited. Increased demands in many areas will have to be met by transporting water much greater distances. Southern California, an extreme case, is now trying to put through a program that would involve building 400-mile-long aqueducts to bring water from the northern end of the State. More and more sewage treatment will be needed, and it seems almost certain that new and probably more costly processes will have to be used to remove inorganic matter that gets through today's plants. A little further in the future, but definitely in sight, is the need to deal with the wastes from nuclear-power generation, a fantastically expensive proposition.

But the basic problem in water and sewers is not money. Nor, for the time being, at any rate, is it technology. The big problem is people. Last year, of the thousands of communities with inadequate water and sewerage facilities, only about 600 were stirred up enough to put bond issues up before the voters. In many instances the towns were under considerable State or Federal pressure to clean up pollution. Yet the citizens of nearly one-quarter of these 600 municipalities—Costa Mesa, Calif., Warwick, N.Y., and La Grange, Ohio, to name a few—turned down the bond issues at the polls. "Some people won't do anything," says one disillusioned city official, "until we have another plague."

The CHAIRMAN. Mr. Hardin, we thank you and the other gentlemen with you for this presentation of the views of your group on this subject matter before the committee.

Without objection these first two exhibits attached to your statement will appear in the record.

Are there any questions? If not, we thank you, sir.

Our next witness is Mr. H. K. Burns, Jr.

Mr. Burns, please come forward. Will you identify yourself please, sir, for the record.

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[1] There is also a Federal loan program for public works, administered by the Community Facilities Administration, to help small communities that are unable to finance projects through normal channels.

STATEMENT OF H. K. BURNS, JR., PRESIDENT, BURNS BRICK CO., MACON, GA.

Mr. BURNS. I am Henry Burns, Jr., president of the Burns Brick Co., in Macon, Ga.

The CHAIRMAN. You are recognized, sir.

Mr. BURNS. Thank you, Mr. Chairman.

Mr. Chairman and gentlemen of the Ways and Means Committee, what I have here is primarily from some notes, and I will expand on them in a couple of places.

I know what a big job you people have in arriving at a fair tax law and do not envy you of it. As I understand the proposal of the Treasury Department, the depletion allowance on brick clays will be when the clay is in the brick machine, or thereabouts. This particular feature I am very much opposed to for the following reasons:

One is the most unrealistic point of cutoff. If anything has no sales value it is clay inside a brick machine. I understand now it is before it gets to the brick machine that they are proposing. Another is that it is impossible to arrive at an exact cost at this point. For instance, in our plant the same motor drives both the pugmill and the brick machine. How are we to determine how much power goes to each?

Our accountant tells me that the bookkeeping cost would be tremendous to try to keep the data that would probably be required.

I would like to state here that we had a revenue representative check our books to arrive at how much depletion allowance we would be allowed in the early stages of this under their old ruling. He spent something like 2 or 3 months down there trying to decide what part of our cost would apply and what part would not apply; a lot of those he had to guess at. I had to help him guess some of them.

This method will also penalize the plants that have a low mining cost. I am particularly thinking of our plant where we have an extremely low mining and preparation cost compared to other plants of my knowledge, because we invested a large sum of money in our mining equipment several years ago.

We have another problem in that with part of our clay we are making a block on which none of the material goes through the pugmill or the brick machine.

I can see the grounds for a great deal of litigation on where the point of cutoff will be on the clay that we use for this product. My thought is that the lower percent of depletion rate that the brick industry has over such as slate, sand, gravel, oil, and so forth, is to compensate for the increased cost necessary for the first salable product.

Frankly, if a change must be made I would prefer it being on the percentage of the sales price of the brick, and then all manufacturers are placed on the same basis and it is much simpler to figure the depletion. It is a new product.

We took the money that we were refunded on our depletion suits and developed an entirely new product that we are now in and I think will go all over the country.

Mr. Alger, I believe, asked how much has been spent on litigation. I can say for our company that we had the foresight to make a trade

with our lawyer first before entering suit so we got out, I believe, for $7,500, because all he had to do was follow the copy of the original suit of Cherokee, since we are in the same town and our processes are very similar.

He made us a special rate. I have heard some of them talk about $30,000 attorney fees, and so forth. I would be glad to verify that fact and drop you a line as to just exactly how much ours was.

The CHAIRMAN. We would be glad to have it.

We thank you very much, Mr. Burns, for your statement.

Mr. BURNS. I thank you.

Mr. SIMPSON. Mr. Burns, in referring to this matter of possible litigation, I just call your attention, and the committee's attention, to page 17 of the statement of the last witness, where he refers to a goodly number of words used in the Treasury proposal, all of which would have to be interpreted legally in the event that were to become the law and would greatly confuse, I think, the allowance of the depletion for several years ahead.

Mr. BURNS. That is a thing that concerns us. We would go back in the courts again.

Mr. SIMPSON. It would cause controversy.

Thank you.

The CHAIRMAN. This concludes the hearings on the subject matters stated in the original notice, but the record will remain open until Friday, March 13, for the receipt of any additional statements or data which interested individuals may desire to include.

Earlier the Chair did not obtain unanimous consent for the reports and summaries of the advisory groups on subchapters (c), (j), and (k) to be entered in the record at the point just preceding the appearance of the representatives of the advisory groups.

Without objection those will appear in the record at that point.

The Treasury proposal, which has not been introduced in bill form, should be included in the hearing just prior to the testimony on this depletion matter, so without objection that, too, will appear in the record at that point.

That concludes this hearing. The committee will adjourn until 10 a.m.

(The following material was filed with the committee:)

HOUSE OF REPRESENTATIVES,
Washington, D.C., March 5, 1959.

Hon. WILBUR MILLS,
Chairman, House Ways and Means Committee, House Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: I herewith transmit to you a letter received from Mr. Orton A. Boren, chairman, depletion committee, Brick & Tile Service, Inc., Greensboro, N.C., in connection with the depletion on brick and tile clays, which is now allowed by law.

It is my sincere hope that your committee will give this matter thorough consideration before accepting recommendations of the Secretary of the Treasury Department.

With kindest personal regards, I am.

Sincerely yours,

A. PAUL KITCHIN.

BRICK & TILE SERVICE, INC.,
Greensboro, N.C., February 24, 1959.

Hon. A. PAUL KITCHIN,
House of Representatives, Washington, D.C.

DEAR MR. KITCHIN: The brick and tile producers of North Carolina appeal to you for assistance in a matter vital to the only large mineral resource industry of your State.

On February 11, Secretary of the Treasury Anderson sent to Congress his Department's recommendations for legislation specifically designed to change the method of computing percentage depletion on brick and tile clays from that now allowed by law and upheld by many court decisions. If the Treasury recommendations are passed into law it will, in effect, eliminate nearly all the tax relief granted producers of brick and tile in 1951, largely due to the efforts of the late Hon. Bob Doughton and Senator Hoey. This is to be accomplished by a change in the definition of "mining" as it existed when Congress voted our tax relief, thereby establishing an artificial value for raw brick and tile clays in absence of any real market value until processed into brick and tile.

It is significant that Mr. Anderson is not requesting a reduction in the depletion rate for brick and tile clays, already in the lowest (5 percent) bracket. Nevertheless, the proposed changes in definition would have the effect of reducing this rate to a small fraction of that percentage as applied to the "first marketable mineral product" under present existing law.

Therefore, our objection to the proposed bill applies to tampering with the definition of mining and the treatment processes considered as mining, because we think Congress knew what it was doing when it granted us tax relief in 1951. However, if it is deemed necessary to make such changes, as Secretary Anderson contends, in order to eliminate complications and prevent unreasonable raids on the Treasury by other industries, it would seem only fair that brick and tile clays and shales be moved to a higher percentage bracket to prevent loss of the tax relief intended by Congress. In other words, if the basis for calculating our percentage of depletion must be changed because of other industries, taxpayers in our industry should be compensated with a higher rate, such as the 27 percent allowed oil producers.

Please be assured that we do not ask for, nor desire, any special favoritism. But as long as percentage depletion is law, we think the proposed change discriminates against our industry and State, which produces one-tenth of the Nation's brick but no oil, coal, sulfur, and so on down a long list of minerals which we North Carolinians are not fortunate enough to enjoy.

Would you mind looking into this matter?

Sincerely,

ORTON A. BOREN,
Chairman, depletion committee.

HOUSE OF REPRESENTATIVES,
Washington, D.C. March 3, 1959.

Hon. WILBUR MILLS,
Chairman, House Ways and Means Committee,
House of Representatives, Washington, D.C.

DEAR MR. MILLS: I call to the attention of your committee the attached letter from Mr. F. G. Burrows, Chehalis, Wash.

Mr. Burrows manages a fairly large brick and tile manufacturing operation and discusses some of the problems of his plant and of similar producers with respect to proposals to change the present depletion allowance provision. I am sure that many other similar plants are affected in the same way.

Sincerely yours,

RUSSELL V. MACK,
Member of Congress.

CHEHALIS BRICK & TILE CO.,
Chehalis, Wash., February 24, 1959.

Hon. RUSSELL MACK,
House Office Building,
Washington, D. C.

DEAR CONGRESSMAN: The Treasury Department is again proposing changes in the depletion allowance granted to the brick and tile industry. We are strongly opposed to these changes as it would greatly affect our tax liability.

Our industry is almost strictly small business. There are only five or six companies which could be classified as medium big business and the balance are small companies like ourselves.

The brick industry is undergoing considerable change due to competition from poured concrete and concrete block which have taken the mass wall, leaving only the outer 4 inches of wall area. This means most of our production is facing brick. Face brick calls for higher quality clays and light burning and buff burning clays which are scarce and located in limited deposits. Our own buff clay is very limited and will last only about another 10 years. This means we have to search for more clay, which we are doing at present time at considerable expense.

When mining buff clay considerable overburden usually must be removed and this adds a great deal to the cost of this clay.

We need the 5 percent depletion allowance to help cover the cost of prospecting and securing new deposits of light burning clay. To remove it would be an extreme hardship on the industry at the present time.

Anything you can do to help our cause will be much appreciated.

Yours very truly,

CHEHALIS BRICK & TILE, CO.,
FREMONT G. BURROWS.

PITTSBURGH, PA., *March 21, 1959.*

Hon. WILBUR D. MILLS,
Chairman, Committee on Ways and Means,
House of Representatives, New House Office Building,
Washington, D.C.

Referring to Treasury proposal that the Internal Revenue Code be amended in its provisions relating to percentage depletion, Hanley Co., producer of large quantities of unglazed face brick, ceramic glazed brick and tile, submits this statement for inclusion in the record of committee hearings and respectfully urges that your committee recommend that the present law be retained without amendment. This would tend toward stability of revenue laws and tend to reduce the necessity for new interpretations, new disagreements, and litigation which is expensive for all. We favor continuation of 15 percent rate for fire clay because of such matters as its relative scarity, difficulty of finding it, and its consequent high value in place. We also believe it essential that classification of minerals, for purposes of determining the percentage rate applicable to them, whether 5 percent, 15 percent or some other rate, be based on their intrinsic qualities and not on the purposes for which they happen to be ultimately used. This would be in accord with the general policy of that part of the proposed Treasury Regulations under the 1939 code as amended which would define "clay, refractory and fire" as "clay which has a pyrometric cone equivalent of 19 or higher," basing the classification on the intrinsic quality of the clay and not on the end use made of it. Use of a 15 percent rate for fire clay and classification according to intrinsic qualities appear to have been the intent of Congress in enacting the present law and, if the committee agrees we believe a statement to this effect in its report may help to simplify administration of the law and avoid expensive and wasteful controversy.

HANLEY CO., *Bradford, Pa.*

STATEMENT OF EARLE T. ANDREWS, NATIONAL INDUSTRIAL SAND ASSOCIATION

My name is Earle T. Andrews. I am vice president of the Pennsylvania Glass Sand Corp. of Lewistown, Pa. I make this statement on behalf of the National Industrial Sand Association and its member companies, which account for approximately 90 percent of the industrial sand production in the United States.

Industrial sand is crystalline silica produced from quartzite and from quartz sand and pebbles. It is the principal ingredient in the manufacture of glass and basic silica chemicals such as sodium and potassium silicates, silica gels and silicones, cores, and molds for castings, refractory linings for glass and steel furnaces, electrical porcelains, and ceramic articles. It is indispensable to the national economy.

CHARACTER OF DEPOSITS

The mineral deposits worked by industrial sand producers range from loosely consolidated granular deposits, which are mined by dredging, to massive rock or vein deposits which are mined or quarried by conventional hard rock methods. Industrial sand must have the unique characteristics of high chemical purity and refractoriness. Competent deposits are scarce and limited in extent. Sands derived from sources other than quartzite and quartz sand and pebbles, such as granite sands, marble sands, limestone sands, construction sands, and other natural and crushed rock sands, do not have the necessary mineralogical qualification to remove other minerals and deleterious impurities, drying, grinding, silica content and inherent purity.

Existing industrial sand deposits are being depleted and the industry must constantly seek to find and develop new deposits.

Quartzite, and quartz sand and pebbles when used for their chemical or refractory properties, are entitled to 15 percent depletion under the 1954 Revenue Code.

INDUSTRIAL SAND TREATMENT PROCESSES

The processes normally applied by producers to obtain commercially marketable industrial sands are crushing, screening, washing, various types of beneficiation to remove other minerals and deleterious impurities, drying, grinding, or pulverization, and loading for shipment. These ordinary treatment proceses reduce the size of the mineral as it comes from the pit or quarry, remove deleterious minerals and other impurities, and prepare for shipment the resulting commercial mineral product as a clean quartz silica. These processes do not in any way change the inherent qualities or chemical composition of the quartz mineral. The general nature of the processes employed and the manner of their application have been traditionally recognized as an essential part of the mining activity.

The product of this industry is a basic raw material, pure silica. It is not an end product for ultimate consumption. Depletion allowances in the industrial sand industry are fully within the contemplation and intention of Congress.

TREASURY DEPARTMENT'S BILL

The Treasury Department, in its concern about what it believes to be excessive depletion allowances accruing to certain industries as a result of court decisions based on the present law, has recommended to the committee a new approach in the determination of "gross income from mining" by eliminating the phrase "commercially marketable mineral product or products" from the statute, and substituting criteria based on a new definition of mining limited by specific lists of allowable and nonallowable treatment processes.

Eliminating the phrase "commercially marketable mineral product or products" and substituting an essentially exclusive list of allowable treatment processes, qualified by such indefinite language as "if necessary to bring the mineral or ore to form and condition suitable for shipment" and "processes which are necessary to bring the mineral or ore to the physical form and condition in which it is capable of being transported as distinguished from those processes applied to make the mineral or ore salable," will, in our opinion, plunge the Treasury Department and taxpayers into endless controversy and litigation in the determination of what constitutes gross income from mining.

The value of the commercially marketable mineral product is a property generally common to all mining operations, regardless of technology or accounting systems, and thus cannot help but be a much more realistic and less

argumentative plane of reference in the computation of percentage depletion allowances than the stage at which the mineral is capable of being transported.

Further, any endeavor to spell out, by name, treatment processes which are to be considered allowable in the determination of gross income from mining is an extremely difficult and hazardous undertaking. It is not, in our opinion, possible to competently define all ordinary treatment processes that are required in the various mineral and ore mining industries to bring the crude ore or mineral to a form and condition of a commercially usable mineral product. Mining industries vary widely in the range of ordinary treatment processes which they employ and technological advances change the character and scope of these processes daily. Undoubtedly, some of the processes now in use are known only to those who use them. Attempts to spell out exclusive lists of such processes can well operate to the serious disadvantage of many who are receiving percentage depletion benefits in a manner fully within the contemplation and intent of Congress.

The amendment also proposes that if any process in the treatment flow sheet is not considered as "mining" and therefore not allowable, all subsequent processes in the flow sheet, regardless of their need or purpose, even though such processes are specifically listed as mining, shall be considered nonallowable. This proposal is arbitrary and can do grave injustice, even though it may not have been so intended. The proposed use of a neutral process category will not readily resolve this problem since it will add one more area of controversy on proper classification of processes.

The Treasury's proposal specifically excludes fine pulverization as an allowable treatment process, although it includes the pulverization of talc. Pulverization, or grinding in mining parlance, is a usual and ordinary treatment process required in many natural resource industries not only to prepare a mineral for beneficiation or concentration but to bring it to the size and physical form required of a basic mineral product suitable for commercial use. The 1954 code specifically included the pulverization of talc as an allowable treatment process. Pulverization is just as important and indispensable to our industry, and we request that any modification of the law which may result from the deliberations of the committee, will not provide for its exclusion as an allowable treatment process.

In conclusion, we believe the Treasury's proposal to determine gross income from mining solely on the basis of specified treatment processes rather than the value of the commercially marketable basic mineral products, will engender many more problems, with their attendant controversy and litigation, than it will resolve. A degree of stability has developed through administrative experience and court decisions in the years that have elapsed since the enactment of the 1954 code. The Treasury's proposals will again subject much of the mining industry to prolonged uncertainty in the final determination of its tax liabilities. The very specificity of the proposal can work unintended hardships on many taxpayers since revenue agents and courts may well imply that treatment processes not listed in the code are not allowable on the assumption that nonlisted processes have been deliberately excluded by Congress.

As a result of the Treasury testimony, concern has been expressed that unless the commercially marketable mineral products test is eliminated from the statute, taxpayers may argue that they are entitled to depletion allowances on manufactured goods such as automobiles and glass. A reading of the statute and a careful consideration of the court decisions will make clear that there is no basis for such concern. The statute defines mining as including extraction and all ordinary treatment processes normally applied by mine owners or operators to obtain the commercially marketable mineral product or products. Thus, to qualify under the statute, the processes must be ordinary treatment processes used in mining industries and the products must be commercially marketable mineral products. Under the plain language of the law it is difficult to see how manufacturers of such items as automobiles and glass could qualify as mine owners or operators applying ordinary treatment processes to obtain commercially marketable mineral products.

The existing law provides a generally equitable and workable framework for the application of depletion allowances and if its administration has resulted in any inequities or extensions not intended by the Congress, such instances should be made the subject of specific remedies without revising the entire framework of the statute.

I appreciate having had the opportunity to present the views of our industry to the committee.

STATEMENT BY JOHN P. ALEXANDER, VICE PRESIDENT, NATIONAL BUILDING GRANITE QUARRIES ASSOCIATION, INC., AND VICE PRESIDENT, NORTHWEST GRANITE MANUFACTURERS ASSOCIATION, INC., ON PROPOSED LEGISLATION SPECIFYING THE TREATMENT PROCESSES WHICH SHALL BE CONSIDERED MINING FOR THE PURPOSE OF COMPUTING PERCENTAGE DEPLETION IN THE CASE OF MINERAL PRODUCTS

This brief is being submitted by the National Building Granite Quarries Association, Inc., and the Northwest Granite Manufacturers Association, Inc. The members of the National Building Granite Quarries Association, Inc., process approximately 75 percent of the granite in the United States which is used for building purposes, and the membership of the Northwest Granite Manufacturers Association, Inc. includes substantially all of the granite producers in the States of Minnesota, Wisconsin, and South Dakota. These States produce approximately 30 percent of the granite produced in the United States.

The press releases dated February 12, 1959, from the Committee on Ways and Means with respect to the legislation submitted by the Treasury Department under dates of January 26, 1959, and February 11, 1959, relating to the proposed amendments to section 613 of the Internal Revenue Code, have been reviewed. We believe that special consideration should be given in this amendment to the natural granite industry for the following reasons:

I. USE OF DIMENSION GRANITE

(*a*) Natural dimension granite is used because of its color and appearance, unlike most mineral products.

(*b*) Dimension granite has no use or market other than in a processed form.

(*c*) The properties of soundness and appearance in natural granite cannot be completely established at any intermediate point in processing.

1. At any point in the processing of natural granite inherent defects can be exposed, rendering the product useless.

(*d*) Special consideration should be given an industry where value or use cannot be measured on a salvage basis or on a weight or measurement basis.

II. BURDEN ON A SMALL INDUSTRY

(*a*) Under the proposed amendment, an artificial and arbitrary basis would have to be established at some intermediate point in processing on which the depletion would be computed.

(*b*) Endless litigtion would result, costly both to the Government and the industry, if an artificial basis must be established at an intermediate point in processing.

III. INTENT OF CONGRESS UNDER EXISTING LAWS

(*a*) The establishment of two rates of percentage depletion, viz: 5 percent for crushed granite and 15 percent for dimension granite, indicates the intent of Congress to recognize the excessive loss and high risk involved in the processing of dimension granite products.

We, therefore, recommend that section 613(c)(3)(D) of the proposed amendment be modified to read as follows:

"(D) The pulverization of talc, the burning of magnesite, the furnacing of quicksilver ores, and the sintering and nodulizing of phosphate rock and the processing of natural granite."

(Whereupon, at 12:35 p.m., the hearings were adjourned.)

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